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In the Supreme Court of the United States

OCTOBER TERM, 1979

FEDERAL ENERGY REGULATORY COMMISSION,
PETITIONER

v.

UNITED GAS PIPELINE COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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The Solicitor General, on behalf of the Federal Energy Regulatory Commission, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case. This petition is conditioned on the granting of the petition for a writ of certiorari in *Tennessee Gas Pipeline Co.* v. *FERC*, No. 79-962, which we intend to oppose. In the event that petition No. 79-962 is denied, we request the Court to deny this petition as well.

OPINIONS BELOW

The opinion of the court of appeals (App. A, *infra*) and its order denying rehearing (App. C, *infra*) are reported at 597 F.2d 581. The orders of the Federal Power Commission and its statutory successor, the Federal Energy Regulatory Commission, Opinion Nos. 815 (App. E, *infra*) and 815-A (App. D, *infra*), are not yet reported.

JURISDICTION

The judgment of the court of appeals was entered on June 22, 1979, and a timely petition for rehearing was denied on August 8, 1979. By order of October 29, 1979, Mr. Justice Powell extended the time for filing a petition for a writ of certiorari to and including January 5, 1980. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, ch. 556, 52 Stat. 831, 15 U.S.C. 717r(b).

QUESTION PRESENTED

Whether Commission Order 465, permitting a gas pipeline to include in its rate base "reasonable and appropriate" advance payments, permits the Commission to impose a requirement that the payments be expended by the recipient within a reasonable time.

STATUTE AND REGULATION INVOLVED

Sections 4(a) and (e) of the Natural Gas Act, ch. 556, 52 Stat. 822, 15 U.S.C. 717c(a) and (e), are set forth in Appendix F, *infra*.

Commission Order No. 465, 48 F.P.C. 1550 (1972), reh. denied, 49 F.P.C. 517 (1973), is set forth at Pet. 79-962 App. 211a-231a.[1]

STATEMENT

A. The Advance Payments Program

The Federal Power Commission initiated the advance payments program in 1970,[2] modified it several times,[3] and, in 1975, terminated the program.[4] The program was an experiment designed to increase the supply of natural gas committed to the interstate market.[5] It was contemplated that interstate pipeline

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[1] "Pet. 79-962 App." refers to the separately bound appendix submitted with the petition in No. 79-962.

[2] *Accounting and Rate Treatment of Advance Payments to Suppliers for Gas*, Order No. 410, 44 F.P.C. 1142 (1970), reh. denied, Order No. 410-A, 45 F.P.C. 135 (1971), aff'd *sub nom. Public Service Commission for the State of New York* v. *FPC*, 467 F.2d 361 (D.C. Cir. 1972).

[3] *Accounting and Rate Treatment of Advance Payments to Suppliers for Exploration and Lease Acquisition of Gas Producing Properties*, Order No. 441, 46 F.P.C. 1178 (1971), reh. denied, 47 F.P.C. 57 (1972); *Accounting and Rate Treatment of Advance Payments Included in Account 166, et al.*, Order No. 465, 48 F.P.C. 1550 (1972), reh. denied, 49 F.P.C. 517 (1973); Order No. 499, 50 F.P.C. 2111 (1973), reh. denied, 51 F.P.C. 818 (1974), remanded *sub nom. Public Service Commission for the State of New York* v. *FPC*, 511 F.2d 338 (D.C. Cir. 1975).

[4] *Accounting and Rate Treatment of Advances Included in Account No. 166, et al.*, 54 F.P.C. 3046 (1975), reh. denied, 55 F.P.C. 803 (1976).

[5] *See Public Service Commission for the State of New York* v. *FPC*, 467 F.2d 361, 363, 367, 369-370, 371 (D.C. Cir. 1972).

companies would advance funds to natural gas producers to explore for, develop, and produce new natural gas supplies in exchange for a commitment of the discovered and developed reserves to the pipeline making the advance. To encourage the pipelines to participate in the program, and to compensate them for the carrying charges associated with these advances, the Commission permitted a participating pipeline to include the advance in its rate base as a part of working capital, and thus to earn a return on the money advanced. Order No. 410, 44 F.P.C. 1142, 1143, 1144 (1970).

From the outset, the Commission stated that only those advances found "reasonable and appropriate" would be included in the pipelines' rate bases (Order No. 410, *supra*, 44 F.P.C. at 1144; Order No. 441, 46 F.P.C. 1178, 1180 (1971). Order No. 465 governed advance payment contracts executed during calendar year 1973. It continued the requirement that advances must be "reasonable and appropriate" in order to be included in a pipeline's rate base. Order No. 499 governed advance payment contracts executed during 1974 and 1975. In that order, the Commission emphasized that the "reasonable and appropriate" standard required that advances be spent by producers on qualifying activities within a "reasonable time." 50 F.P.C. 2111, 2115 (1973).

On December 31, 1975, the Commission discontinued the advance payments program. No advance payments made pursuant to contracts executed thereafter are eligible for inclusion in a pipeline's rate base under the program. Advance payments made

under pre-existing agreements can be included in a pipeline's rate base through December 1985, to the extent that they qualify under the particular rulemaking order governing the period in which the agreement was executed.

B. The Proceedings Below

In September 1973 and April 1974, United Gas Pipe Line Company filed proposed increases in its rates subject to the Commission's jurisdiction (App., 45a, *infra*). The Commission accepted the proposed rate increases for filing, suspended their effectiveness, and consolidated the two filings for hearing and decision (App., 45a-46a, *infra*). United, the Commission staff, and United's customers ultimately reached agreement on substantially all the issues involved in the proposed rate increases. One of the unresolved issues involved the propriety of including certain advance payments in United's rate base (App., 50a-51a, *infra*).

In Opinion No. 815 (App., 44a-72a, *infra*), the Commission denied rate base treatment for approximately $23 million in advance payments made by United pursuant to Order Nos. 465 and 499.[6] It found that the advance payments were "front-end" advances[7] and, hence, presumptively extravagant. Al-

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[6] United has filed additional proposed rate increases in which it has included the advances in question in this case in its rate base. The instant decision will govern the treatment of advance payments in those proceedings as well.

[7] "Front-end" advance payments are advances paid to the producer before he has made expenditures on qualifying ac-

though that presumption could be rebutted by a showing that the front-end advance was "reasonable and appropriate because a positive benefit is conferred on the consumer," United made no such showing (App., 62a-63a, *infra*). Accordingly, the Commission ruled that advances made during the period used to develop United's rates, but not expended by the producer within 30 days after the close of that period, were extravagant expenditures by United and not reasonable. On rehearing, the Commission stated that as soon as the producers had spent the money for the purposes for which it had been advanced, United could again seek to include the payments in its rate base (App., 31a-32a, *infra*).

On United's petition for review, the court of appeals reversed the Commission's orders with respect to United's advance payments governed by rulemaking Order No. 465 (App., 13a-14a, *infra*). The court found that the 30-day presumption, as applied to these payments, "arbitrarily imposes a new dimension and a new restraint" (App., 13a, *infra*). Since Order No. 465 itself gave "no detail, or even broad explanatory statements, instructing the pipelines regarding a payment-expenditure relationship" the subsequent refusal to permit the inclusion of front end advances on a theory of presumptive extravagance constituted, the court believed, an impermissible

tivities. Producers often pressed pipelines to advance funds before they were needed for qualifying expenditures. Pipelines, competing among themselves for gas, frequently acquiesced in producers' demands for these "front-end" advances.

"after-the-fact, in fact retroactive, imposition of standards." *Ibid.* Accordingly, it reversed that portion of the Commission's decision (App., 14a, *infra*).

The Commission petitioned for rehearing to reconcile the disposition here and the disposition by the District of Columbia Circuit in *Tennessee Gas Pipeline Co., et al.* v. *FERC*, 606 F.2d 1094 (D.C. Cir. 1979), remanding for further proceedings a similar Commission order refusing to include front-end advance payments made under Order No. 465. The Fifth Circuit denied rehearing (App., 23a, *infra*).

C. The Tennessee Case

In Opinion No. 769 (Pet. 79-962 App. 73a-158a) and Opinion No. 769-A (*id.* at 159a-205a), the Commission excluded approximately $133 million in front-end advance payments from Tennessee Gas Pipeline Company's rate base (*id.* at 98a, 99a-100a, 102a-107a, 160a-172a). It ruled, as it did in the instant case, "that front-end advance payments are presumptively extravagant" (*id.* at 106a), but that the pipeline

[8] Some of the advance payments at issue were made under Order No. 499. The court concluded "that order did impose some timing requirement, but * * * that this relatively vague guideline did not constitute sufficient notice to the pipelines that they must make all advances on a 30-day installment basis" (App., 4a-15a, *infra*). It found that the evidence on which the Commission relied to support the 30-day standard was inadequate, and that the Commission acted "unreasonably in applying a 30-day reasonableness standard to United's Order No. 499 advances" (*id.* at 19a). It therefore reversed the Commission's orders with respect to Order No. 499 advances, but remanded those orders to give the Commission the opportunity to supplement the record (*ibid.*).

could obtain rate base treatment for such advances by demonstrating that they provide "a positive benefit to the consumer" (*id.* at 107a).

On petitions for review, the District of Columbia Circuit found unsupported the Commission's ruling that advances not expended within 30 days of the close of the period used to determine the pipeline's rates were ineligible for inclusion in the rate base, but remanded the case for further consideration (Pet. 79-962 App. 1a-72a). The court emphasized the experimental nature of the program, and ruled that the Commission "has not abused its discretion in discerning a reasonable timing requirement and in rejecting petitioners' 'business judgment rule' as the 'sole test' for the program's administration" (Pet. 79-962 App. 28a-29a). Rather, it held that the pipeline had the burden of demonstrating an affirmative authorization for extended front-end advances, since such advances are a departure from the historic ratemaking precept that an item may be included in rate base only when it is used and useful for service to current ratepayers (*id.* at 29a-32a). Further, the court held that the Commission's adoption of a reasonable timing requirement was not retroactive rulemaking: "The pipelines had fair notice both of traditional regulatory principles and that the advance payment program exception was put forward and affirmed on a basis that did not encompass the departure asserted by petitioners" (*id.* at 43a). The court concluded, however, that the Commission's presumption that advance payments not expended within

30 days of the close of the rate period were extravagant was "unduly restrictive in that it failed to take account of all factors relevant to the 'reasonable timing' inquiry" and lacked the flexibility that was a key element in the program's experimental nature (Pet. 79-962 App. 48a). Accordingly, the Court remanded the cases "for a more extensive and flexible inquiry by the Commission into the reasonableness of attempts to protect the rate payers from excessive costs" (*id.* at 51a).

REASONS FOR GRANTING THE PETITION

The court below concluded that the requirement in Order 465 that advance payments includible in the rate base must be "reasonable and appropriate" did not permit the Commission to impose any timing requirement on such payments—in effect, that the time within which the advance payments were expended by the gas producer was unrelated to the reasonableness of th advance. In contrast, the District of Columbia Circuit in *Tennessee Gas Pipeline*, No. 79-962, recognized that a timing requirement is an appropriate component of a determination of the reasonableness of advance payments, and rejected the notion that Order 465 was intended to "validate any 'timing' arrangement that a pipeline found justified" in order to compete for scarce gas (Pet. 79-962 App. 42a). The cases thus are in direct conflict.

While we believe that the District of Columbia Circuit's interpretation of Order 465 is correct, we do not assert that the question of the proper interpretation

of that order, which governs only contracts executed in 1973 [9] under a terminated experimental program, merits review by this Court.[10] Indeed, as noted, we intend to oppose the petition filed in that case. Nevertheless, if the Court grants the petition in No. 79-962, it should also grant this petition, so that the interpretation of Order 465 will be uniform for pipelines and consumers throughout the country. Cf. *Northern Natural Gas Co.* v. *Kansas Commission*, 372 U.S. 84, 91-92 (1963).

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[9] The court below interpreted the slightly different language of Order 499, governing advance payment agreements executed in 1974 and 1975, in a manner consistent with the approach of the District of Columbia Circuit, since it remanded the rulings under that order to the Commission for reconsideration. See note 8, *supra*.

[10] The reasons why we oppose review of this issue by this Court will be spelled out in more detail in our brief in opposition in No. 79-962, which we will file as soon as possible. We are sending a copy of this petition to petitioners in No. 79-962; we will send respondents here a copy of our opposition in No. 79-962 as soon as it is filed.

CONCLUSION

If this Court grants the petition for a writ of certiorari in No. 79-962, it should also grant this petition. If the petition in No. 79-962 is denied, this petition should also be denied.

Respectfully submitted.

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JANUARY 1980

APPENDIX A

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 78-1091

UNITED GAS PIPE LINE REGULATORY COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

June 22, 1979

Petition for Review of Orders of the Federal Energy Regulatory Commission.

Before BROWN, Chief Judge, COLEMAN and TJOFLAT, Circuit Judges.

JOHN R. BROWN, Chief Judge:

In this case United Gas Pipe Line Company (United) and various intervenors [1] contend that the Federal Energy Regulatory Commission (FERC) has acted arbitrarily in denying recovery of costs that they should reasonably be able to pass on to their

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[1] Tennessee Gas Pipeline Company, a division of Tenneco Inc., Natural Gas Pipeline Company of America and Columbia Gas Transmission Corporation.

customers. We agree that the challenged Commission action [2] is unreasonable and, therefore, reverse.

The Commission Sets The Stage: Background

This dispute began when—in the context of a critical natural gas shortage—the Commission [3] issued Order 410,[4] which announced the initiation of its advance payment program. Under this program inter-

[2] Specifically, plaintiffs appeal from Commission Opinions No. 815 and 815-A.

[3] This order was issued by the Federal Power Commission. Pursuant to the Department of Energy Organization Act, Pub.L. No. 95-91, 91 Stat. 565 (1977), 42 U.S.C.A. §§ 7101, *et seq.* (Supp. 1977), and Executive Order No. 12,009, 42 Fed. Reg. 46,267 (1977), on October 1, 1977, the Federal Power Commission (FPC) ceased to exist and most of its regulatory responsibilities, including those under Section 4 of the Natural Gas Act, 15 U.S.C.A. § 717c, were transferred to the Federal Energy Regulatory Commission (FERC). Accordingly, as used herein, the term "Commission" means the FPC when referring to actions taken prior to October 1, 1977, and means the FERC when referring to actions taken on or after October 1, 1977.

[4] *Accounting and Rate Treatment of Advance Payments to Suppliers for Gas and Amending F.P.C. Form No. 2,* FRC Order No. 410, 44 FPC 1142 (1970). The Commission's other initial advance payment orders clarified and slightly modified Order 410: *Accounting and Rate Treatment of Rate Payments to Suppliers for Gas and Amending F.P.C. Form No. 2,* FPC Order No. 410-A, 45 FPC 135 (1971); *Accounting and Rate Treatment of Advance Payments to Suppliers for Exploration and Lease Acquisition of Gas Producing Properties,* FPC Order 441, 46 FPC 1178 (1971), *rehearing denied,* 47 FPC 57 (1972).

state pipeline companies advanced funds, interest free, to producers for exploration and development of natural gas reserves. The producers, in turn, committed the gas to be developed with those funds to the individual pipeline companies that had made the advances and thus to the interstate market. To encourage the pipelines to participate and to offset the resultant costs of the program, the Commission allowed them to include the costs of the advance payments in the rate base.[5]

In doing so the Commission explained that this method of accounting would have "encouraging effects" on gas supply. 44 FPC at 1143. It further stated that,

> particularly at the present time when there are indications of a natural gas shortage, it is not in the public interest for pipeline companies to bear the costs of assuring themselves and their customers a future supply of natural gas. We believe that, when it is necessary for pipeline companies to make advance payments in order to contract for gas supplies, it is equitable that the companies should earn on the amounts advanced.

Id. at 1144.[6] Order 410 and its companion or-

[5] Costs included in rate base are those on which the pipeline may earn a return by inclusion in the price of gas service to their customers.

[6] In Order No. 410-A, *see* note 3, *supra,* the Commission stated that ". . . we have determined that advances by pipelines to independent producers for exploration and lease acquisition costs will be assured of accounting and rate treat-

ders,[7] which governed the program from its inception through December 28, 1972, were affirmed by the Circuit Court of Appeals for the District of Columbia as a "justifiable experiment in the continuing search for solutions to our Nation's critical shortage of natural gas." *Public Serv. Comm'n of New York* v. *FPC*, 1972, 151 U.S.App.D.C. 307, 317, 467 F.2d 361, 371 (*New York Comm'n I*).[8]

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ment pursuant to Order No. 410 as modified herein." 45 FPC at 135.

In Order 441, *see* note 3, *supra*, the Commission restated its concern that

> a critical shortage of gas exists in the United States; capital formation for gas development is difficult. *The objective of providing capital to accelerate the addition of new gas supplies* supports our continuation for the limited period of the rate treatment of advance payments provided herein.

46 FPC at 1180 (emphasis added). It then made a change in the accounting procedure for handling advance payments. The original Account 166 would still contain includable (in rate base) advances—those that "are *reasonable necessary and appropriate in order to contract for gas supplies . . . .*" *Id.* (emphasis added). But a new account, 167, would contain "all other advance payments for gas, including exploration and lease acquisitions. Reasoning that such advances "have not shown to be an effective vehicle for stimulating the widespread participation in natural gas production for which their encouragement was intended," the Commission determined that they should not be included in rate base. *Id.*

[7] Orders 410-A and 441.

[8] As the D.C. Circuit explained in *Public Serv. Comm'n of New York* v. *FPC*, 1975, 167 U.S.App.D.C. 100, 103, 511 F.2d 338, 341 (*New York Comm'n II*) in its prior opinion it had

> sustained the advance payment scheme on the basis of "the temporary character of the FPC order" and "our belief that it represented a justifiable experiment . . . ." We stressed the need for further evaluation by the FPC prior to any continuation of rate base treatment of advance payments to producers.

In late December of 1972 the Commission issued its Order 465,[9] which extended the advance payment program for one year, up to Dec. 31 1973, and made specific changes regarding which costs could appropriately be included in rate base base and the schedule for repayment of advances. Following a round of comments from various producers, pipelines, and affiliated companies, the Commission again extended the program up to December 31, 1975, in its Order 499.[10] It also announced a general policy to deny rate base treatment for advances "in excess of costs for exploration and development, and production incurred by the producer within a reasonable time from the date such amounts advanced are included in the pipeline's rate base." [11] Before Order 499 the only guidance the Commission has offered provided that advances would

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[9] *Accounting and Rate Treatment of Advance Payments Included in Account 166, Advance Payments for Gas Development and Production*, FPC Order No. 465, 48 FPC 1550 (1972), *rehearing denied*, 49 FPC 517 (1973).

[10] *Accounting and Rate Treatment of Advances Included in Account No. 166, Advances for Gas Exploration, Development and Production*, FPC Order No. 499, 50 FPC 2111 (1973), *rehearing denied*, 51 FPC 818 (1974).

[11] 50 FPC at 2115. While the Commission expanded the program's reach in several areas, this was the only limitation it contained.

be allowed in rate base if found reasonable and appropriate.[12]

Upon review of Orders 465 and 499 the District of Columbia Circuit held that the Commission's action did not "amoun[t] to the kind of evaluation of the experience under the programs [required] to discharge [its] responsibility 'to determine [as instructed in *New York Comm'n I*, 467 F.2d F.2d at 371] whether its justifying objectives are being satisfactorily met at an acceptable level of ultimate economic cost to the nation's gas consumers.'" 167 U.S. App.D.C. at 110, 511 F.2d at 348.[13] The Court thus remanded the proceeding for further consideration, but allowed the advance payment program to remain in effect pending Commission action on remand. In response to the District of Columbia's mandate, the Commission issued its Order on Remand,[14] terminating the program prospectively as of December 31, 1975.

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[12] This is essentially the standard Congress has imposed on all natural gas rates. See § 4(a) of the Natural Gas Act, 15 U.S.C.A. § 717c(a).

[13] The Court further explained that

> [j]ustification of the program depends on the attraction of new or additional quantities of gas supply to the interstate market, . . . The record fails to disclose any effort by the FPC either to quantify the amount of gas attracted, . . . or to gauge the average time saved as a result of the program's speeding of capital formation.

Id.

[14] *Accounting and Rate Treatment of Advances Included in Account No. 166, Advances for Gas Exploration, Development and Production,* Docket Nos. R-411 and RM 74-4 (Order on Remand for Court Opinion Terminating Investigation and Terminating Programs with Conditions) (December 31, 1975).

The Star Makes Her Entrance: United's Case

United participated in the Commission's advance payment program [15] and, in various rate proceedings, applied for rate base treatment of the costs of making advances. The proceedings in question here concerned costs incurred from April 6, 1974, through May 19, 1975 (the period). Settlement negotiations among United, the Commission staff, and United customers ultimately resulted in a Stipulation and Agreement pursuant to which United's rates and refunds were based on United's actual operating experience during such period.[16] After reviewing the settlement agreement, the Commission issued Order No. 815,[17] in which it approved the agreement, but only with the addition of significant modifications. One of these was the denial of rate base treatment for $23,380,650 of the $79,238,960 of outstanding advances United carried

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[15] Most of United's advances are governed by Order 465, with the remainder being governed by Order 499.

[16] During the settlement negotiations, the parties agreed to reserve three issues for decision by the Commission. A hearing was held on these issues, and the Presiding Law Judge certified the record and the Stipulation and Agreement to the Commission on December 24, 1975. We have before us only the Commission's modification of the settlement agreement.

[17] *United Gas Pipe Line, Opinion and Order on Reserved Issues and Otherwise Approving Settlement Agreement,* Docket Nos. RP 74-20, RP 74-83, Opinion No. 815 (July 29, 1977).

during the period. Reasoning that all advances spent more than 30 days after inclusion in rate base (front-end advances) were "presumptively extravagant" [18] the Commission found that it would be unjust and unreasonable to pass the costs on to United's customers.

United sought rehearing on Opinion No. 815, thus prompting the Commission's issuance of Opinion No. 815-A. In response to United's argument that the Commission had elevated its "presumption" to a retroactively applied legal standard, the Commission merely stated that

> [o]ur conclusion that a portion of United's advance payments at issue in this proceeding are unreasonable and inappropriate costs for rate making purposes reflects nothing more than our judgment on the record that the carrying cost of the advances challenged in this case should not be borne by United's consumers. The Commission has not announced a new rule and applied it retroactively.

Apparently distinguishing between the meaning of "reasonable" in regulatory and business contexts, the Commission further added that

[18] *In Tennessee Gas Pipeline Co.*, Opinion No. 769, 55 FPC —(July 9, 1976), *mimeo* at 31, the Commission first held that front-end advance payments, i.e., those made by pipelines but not spent by the producers within thirty days of their inclusion in rate base) were "presumptively extravagant" under Order No. 499, 50 FPC 2111 (1973). It further explained, however, that a finding of presumptive extravagance "may be rebutted by a showing that the front-end advance is, nevertheless, reasonable and appropriate because a positive benefit is conferred on the consumer." *Mimeo* at 32.

> [t]he 'reasonable and appropriate' standard applied here is simply a restatement of this Commission's statutory obligation to review all pipeline expenditures in order to determine their prudence. We do *not* find that, as a matter of business acumen, United was unwise to enter into front-end advance payment agreements. We find only that under settled rate making practices these particular expenditures by United were of no present benefit to its customers during the locked in period involved in this case.

The Plot Thickens: United's Claims And The Applicable Law

United now appeals to this Court, claiming that because they gave insufficient guidance regarding any timing relationship between advance and expenditure, the Commission's Orders 465 and 499 did not constitute reasonable notice of the FERC's subsequently imposed 30-day presumption. Moreover, United asserts, the Commission did not properly analyze the circumstances surrounding the advancing of the funds. The § 4(a) "just and reasonable" standard [19]

[19] Section 4(a) of the Natural Gas Act, 15 U.S.C.A. § 717c(a):

> (a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.

and has determined that in this case, considering all the record evidence, 30 days was a reasonable time to allow between the pipeline's advances and the producers' spending the funds.

The Supreme Court has defined our responsibilities as a reviewing Court:

> First, [we] must determine whether the Commission's order, viewed in light of the relevant facts and of the Commission's broad regulatory duties, abused or exceeded its authority. Second, [we] must examine the manner in which the Commission has employed the methods of regulation which it has itself selected, and must decide whether each of the order's essential elements is supported by substantial evidence. Third, [we] must determine whether the order may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection to the relevant public interests, both existing and foreseeable.

Permian Basin Area Rate Cases, 1968, 390 U.S. 747, 791-92, 88 S.Ct. 1344, 1373, 20 L.Ed.2d 312.

It has further instructed that:

> [a] presumption of validity . . . attaches to each exercise of the Commission's expertise, and those who would overturn the Commission's judgment undertake "the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences."

Id. at 767, 88 S.Ct. at 1360. We are not, however,

> obliged to examine each detail of the Commission's decision; if the "total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the [Natural Gas] Act is at an end".

Id.

We thus begin our consideration of this appeal with an examination of the context in which United made its advance payment contracts. As we have previously explained, this was "a time of severe natural gas shortage when experimental programs fashioned to alleviate this problem were being implemented." *United Gas Pipeline Co.* v. *FPC*, 1977, 179 U.SApp. D.C. 274, 551 F.2d 460. In one of these programs the Commission not only authorized but encouraged pipelines to make essentially interest free loans in order to attract natural gas supplies for interstate pipelines.[20] Creating the impression that it was regulating the particulars of the program,[21] the Commis-

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[20] Since producers could sell at higher prices intrastate, this program was presumably designed to induce producers to sell to pipelines those supplies previously sold on the intrastate market and those for which producers would have a strong economic inducement to *commit* to the intrastate market.

[21] Two examples of these seemingly specific guidelines are (1) Order 441's addition of a requirement that the advances be repaid even if production was not obtained and (2) Order 465's addition of a requirement that advances be removed from rate base at the end of five years if deliveries had not commenced or immediately if gas developed with the advance was sold to a company other than the pipeline making the advance.

sion modified and clarified its initial advance payment order several times between 1970 and 1973. None of these modifications, however, specified a concrete timing relationship between pipeline's advance and producer's expenditures.

As a result of the Commission's program, advance payments became an accepted practice, indeed an essential tool,[22] for pipelines attempting to contract for

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[22] *See* testimony of United's witness D. Lamar Smith, R. at 47-56.

Although the District of Columbia Circuit in New York Comm'n II questioned, if not repudiated these findings of the Commission largely because the data were insufficient to show a relationship between the advances and increased proven reserves—a matter on which we might well have quite different views, *see Placid Oil Co.* v. *FPC*, 5 Cir., 1973, 483 F.2d 880, *aff'd sub nom., Mobil Oil Corp.* v. *FPC*, 1974, 417 U.S. 283, 94 S.Ct. 2328, 41 L.Ed.2d 72—Opinion 499 stated that

> [o]ur review of the data compiled in the Summary Report indicates that the advance payment program has continued to meet its objectives of bringing additional gas supplies into the interstate market at acceptable cost to the nation's gas consumers. The total amount of proven reserves resulting from the advance payment program has increased from 9.5 trillion cubic feet (Tcf) in the lower 48 states noted in Order 465 to approximately 10.3 Tcf. A more significant increase has occurred in the total of potential reserves discovered within the lower 48 states which has risen from a level of 4.75 Tcf in Order 465 to a level of 9.5 Tcf in the present Summary Report. This dramatic increase in potential reserves has occurred, for the most part, as a result of advances made pursuant to contracts subject to Order No. 465. This is borne out further by a comparison of the levels of proven and potential reserves found in the first 7-8 months period under Order 441 (46 FPC 1178) and a comparable period under Order No. 465. For Order 411, the level of

gas supplies. When, in Order 499, the Commission did announce its intention to impose some sort of requirement, it merely provided that the advances had to be expended within a reasonable time after their inclusion in rate base. "There was no hint whatsoever of a rigid 30-day rule or 'line of credit' analysis being read into Order No. 499." [23] *Natural Gas Pipeline Co.* v. *FERC*, 7 Cir., 1979, 590 F.2d 664 (1979).

Examining first the Order 465 advances, we find that the Commission unreasonably denied rate base treatment. The 30-day "presumption," as applied to these payments, arbitrarily imposes a new dimension and a new restraint, especially in light of other spe-

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> proven resources was .8 Tcf while under Order 465 it was .5 Tcf. However the level of *potential* reserves within the lower 48 states increased from .56 Tcf under Order 441 to 4.97 under Order 465. This increase in the level of potential reserves is due, in part, to the fact that Order No. 465 re-allowed exploratory advances while continuing to permit advances for gas development and production while advances under Order 441 were limited to gas development and production alone.

[23] The ALJ who issued the initial decision in *Columbia Gas Transmission Corp.*, Docket Nos. 71-18, issued January 18, 1974, apparently agreed. He expressly rejected the staff's proposal of a rigid 30-day rule:

> On the other hand, none of these orders mentions any of the specific requirements contended for by the staff, that an advance payment must be shown to be related to the producer's costs, strictly limited to the amount and to the time actually needed, as prerequisites for granting approval of rate base treatment.

Mimeo at 19-20.

cific modifications in 465 and previous orders.[24] The Commission's Orders 465 and 499 provided no detail, or even broad explanatory statements, instructing the pipelines regarding a payment-expenditure relationship. The first time they really announced this requirement was in Opinions 769 and 769-A, see note 18, *supra*. The law will not tolerate this sort of after-the-fact, in fact retroactive, imposition of standards. *Hill* v. *FPC*, 5 Cir., 1964, 335 F.2d 355.[25] Moreover, there was simply no evidence either to support or justify the presumption of extravagance for these non-thirty day advances. The Commission stresses the testimony of Staff Witness Benna, but as we will later discuss, he did not really address the issue. We thus reverse the Commission's determination and approve the settlement agreement regarding the advances made during the period covered by Order 465.

Regarding the Order 499 advances we also think that the Commission imposed an unreasonably harsh standard. Admittedly, that order did impose some timing requirement, but we agree with the Seventh Circuit that this relatively vague guideline[26] did not

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[24] *See* note 21, *supra*.

[25] The Court stated that

> [t]he question in this case is whether it is too late for an agency to declare the standards to be met by its decision holding that they have not been met. The answer, quite obviously, is in the affirmative.

335 F.2d at 356.

[26] Again, we emphasize that this guideline appears vague in relation to other much more specific provisions in the advance payment orders.

constitute sufficient notice[27] to the pipelines that they must make all advances on a 30-day installment basis.[28] In response to the Commission's insistence that it has not applied the 30-day "presumption" as a rigid rule, we point out that since its initial application in Opinion 769,[29] the Commission has imposed 30 days as the standard of reasonableness in every advance payments rate proceeding.[30]

In justifying its application of presumptive invalidity in this case the FERC relied heavily on the

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[27] The Commission must offer guidelines of sufficient clarity and specificity that pipelines may reasonably determine whether they may properly incur certain costs. *See FPC* v. *Texaco*, 1974, 417 U.S. 380, 393, 395-96, 94 S.Ct. 2315, 41 L.Ed.2d 141.

[28] *Natural Gas Pipeline Co.* v. *FERC*, *supra*, 590 F.2d at 669. In this case the Seventh Circuit reversed Commission orders denying rate base treatment for Order 499 advances. Finding the 30-day rule impermissibly retroactive, it remanded the proceedings to the Commission for further consideration.

[29] *See* note 18, *supra*.

[30] *Tennessee Gas Pipeline Co.*, Opinion Nos. 769 and 769-A, *supra*, *appeal pending*, No. 77-1496 (D.C. Cir., filed June 2, 1977); *Michigan Wisconsin Pipe Line Co.*, Docket No. RP 73-102 (July 6, 1977); *Texas Eastern Transmission Corp.*, Docket No. RP 75-73 (June 6, 1977); *Michigan Wisconsin Pipe Line Co.*, Docket No. CP 70-22 (June 3, 1977 and August 1, 1977), No. 77-1719 (D.C. Cir.); *Truckline Gas Co.*, Docket Nos. RP 72-23, *et al.*, (June 3, 1957); *Truckline Gas Co.*, Docket Nos. RP 72-23, *et al.*, RP 73-35 (June 3, 1977); *Natural Gas Pipeline Co. of America*, Docket No. RP 73-110 (June 3, 1977 and August 1, 1977), *reversed*, *Natural Gas Pipeline Co.* v. *FERC*, *supra*; *Transcontinental Gas Pipe Line Corp.*, Opinion Nos. 801-A (May 31, 1977 and July 29, 1977), *appeal pending*, No. 77-1712 (D.C. Cir.).

testimony of staff witness Benna, who stated that from his two years experience working as an Engineer-Mechanical with Shell Oil Co., he had determined that most producers had to pay their bills within 30 days. Based on this information, he had concluded that 30-day installment advances would provide sufficient leeway to allow producers to finance exploration or development of new gas supplies.

There are a number of reasons why we conclude that this testimony carries little weight and is inadequate to support the Commission's holding. First, as United points out, Benna was not involved in Shell's accounting or financial departments. In testifying simply that producers paid current bills in thirty days, he failed to deal with the fiscal requirements of producers in undertaking the often substantial advance-commitment obligations. Even had Order 499's test [31] been the Commission's stated policy throughout the program, this reasoning—unaccompanied by other more persuasive evidence—could not have justified FERC's now disallowing front-end advances.

Second, the witness did not know or attempt to evaluate what costs other than the payment of current bills were incurred or accrued by each of the producers—some of which had limited financial re-

[31] *See* 50 FPC at 2115, in which the Commission states that it will not consider as "reasonable and appropriate" any advances that are "in excess of costs for exploration, development and production incurred by the producers within a reasonable time from the date such amounts advanced are included in the pipeline's rate base."

sources—in participating as integral parts of a program of such magnitude. Indeed he as much admitted that he lacked such knowledge in his admission that, in his studies of seven typical advance payment projects,[32] less than five percent, if that many, of the advances were made in the manner in which he proposed. This testimony, standing essentially alone, does not support the Commission's action regarding United's Order 465 or 499 advances.

The Supreme Court's opinion in *NLRB* v. *Bell Aerospace*, 1974, 416 U.S. 267, 94 S.Ct. 1757, 40 L.Ed.2d 134, does not aid the Commission's defense of its Orders 815 and 815-A. The Opinion does support allowance of agency discretion:

> [it is] plain that the Board is not precluded from announcing new principles in an adjudicative proceeding and that the choice between rulemaking and adjudication lies in the first instance within the Board's discretion.

Id. at 294, 94 S.Ct. at 1771. It indicates, however, that some limits govern that discretion:

> The possible reliance of industry on the Board's past decisions with respect to buyers does not

[32] *See* R. at 208. Benna had examined advance payments made in the matters of Natural Gas Pipeline Company of America, Docket Nos. RP 72-132 and RP 73-110, Columbia Gas Transmission Corp., Docket No. RP 73-86, Tennessee Gas Pipeline Co., a Division of Tenneco, Inc., Docket No. RP 73-113, Cities Service Gas Company, Docket No. RP 74-4, McCulloch Interstate Gas Company, Docket No. RP 73-103, Kansas-Nebraska Natural Gas Company, Docket No. RP 74-11 and Truckline Gas Company, Docket Nos. RP 72-23, *et al.*, and RP 73-35.

> require a different result. It has not been shown that the adverse consequences ensuing from such reliance are so substantial that the Board should be precluded from reconsidering the issue in an adjudicative proceedings. Furthermore, this is not a case in which some new liability is sought to be imposed on individuals for past actions which were taken in good-faith reliance on Board pronouncements.

Id. at 295, 94 S.Ct. at 1772.

We think that the Commission's action in Orders 815 and 815-A falls within the exception contemplated in *Bell Aerospace*. Clearly, if the orders stand, United and other pipeline companies will incur substantial unrecoverable costs in reliance on past Commission decisions.[33] We cannot help but think that the resulting enormous yearly losses would hinder the Commission's very purpose for instituting the program.[34]

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[33] Counsel for United informed us at oral argument that the costs of carrying the $23,380,650 of outstanding advances for the period in question (about one year) will amount to about 3 million dollars.

[34] The Commission made it clear in its advance payment orders that maintenance of adequate service—more than *merely* regulation of costs—was a major concern of the program. *See* note 6, *supra*. *See also New York Comm'n I*, *supra* 151 U.S.App.D.C. at 316, 467 F.2d at 370; "In rate-making under the Natural Gas Act, the intent of Congress was that gas should be sold at the lowest possible reasonable rate *consistent with the maintenance of adequate service in the public interest.*" (Emphasis added). (Citing *Cincinnati Gas & Electric Co.* v. *FPC*, 6 Cir., 1968, 389 F.2d 272, 276; *Atlantic Refining Co.* v. *FPC*, 1963, 115 U.S.App.D.C. 26, 316 F.2d 677, 678; *Lynchburg Gas Pipeline Co.* v. *FPC*, 1964, 119 U.S.App.D.C. 23, 336 F.2d 942 (concurring opinion)).

Having found that the Commission acted unreasonably in applying a 30-day reasonableness standard to United's Order 499 advances, we reverse the Commission's orders as they relate to those payments and remand for further Commission action consistent with this opinion.

The Curtain Falls: Conclusion

We fully recognize the Commission's duty to protect consumers from excessive natural gas prices and more importantly, the obligation of the Commission to consider in rate fixing the continuation of an adequate supply to meet consumer's demands, both now and in the future. We also realize, however, that the pipelines are bound to provide adequate service to their customers. When the companies, with Commission blessing, have acted reasonably in incurring certain costs to obtain gas supplies, the customers will have to pay. The alternative is no gas service. The Supreme Court recognized the pipelines' dilemma in *FPC* v. *Texaco*, noted *supra* 417 U.S. at 393, 94 S.Ct. 2315, when it expressed concern that, in the absence of proper Commission guidance, pipelines would risk incurring unrefundable (from producers) expenses that might later be disallowed (in rate base). Indeed the Commission has already approved producer profits from the advances at issue here, thus precluding re-

fund actions. Opinion Nos. 770 and 770-A,[35] *aff'd, American Public Gas Ass'n* v. *FPC*, 1977, 186 U.S. App.D.C. 23, 567 F.2d 1016,[36] *cert. denied*, 1978, 435 U.S. 907, 98 S.Ct. 1456, 55 L.Ed.2d 49.

The District of Columbia Circuit declared the advance payment program unsuccessful and refused to transfer the burden of its "scattered uneven impact" to producers who had received advance payments before November 5, 1976.[37] Similarly, we will not allow the Commission to force United to bear the brunt of the Commission's bankrupt program. We reverse as to the 465 advances, reverse and remand as to the 499 advances.

REVERSED IN PART; REVERSED AND REMANDED IN PART.

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[35] These orders were issued on July 27, 1976, and November 5, 1976, respectively.

[36] The Commission had held that a producer who accepted an advance payment after November 5, 1976, (pursuant to a preexisting contract) would be required to make rate adjustments reflective of the lower cost of capital. No such requirement was imposed on producer acceptance of advances before that date.

[37] *American Public Gas Ass'n*, 186 U.S.App.D.C. at 62-64, 567 F.2d *supra* at 1055-57.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

October Term, 19

No. 78-1091

F.E.R.C. No. RP74-20, et al.

UNITED GAS PIPELINE COMPANY, PETITIONER

versus

FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT

Petition for Review of Orders of the
Federal Energy Regulatory Commission

Before BROWN, Chief Judge, COLEMAN
and TJOFLAT, Circuit Judges

JUDGMENT

This cause came on to be heard on the petition of United Gas Pipeline Company for review of orders of the Federal Energy Regulatory Commission, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the orders of the Federal Energy Regulatory Commission in this cause be, and the same are hereby, reversed in part; reversed and remanded in part to the said Federal Energy Regulatory Commission in accordance with the opinion of this Court.

June 22, 1979

A true copy
Test:

Clerk
U.S. Court of Appeals
Fifth Circuit

By /s/ Brenda Hauck
Deputy
New Orleans, Louisiana

Aug. 16, 1979

Issued as Mandated: Aug. 16, 1979

APPENDIX C

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 78-1091

[Filed Aug. 8, 1979]

UNITED GAS PIPELINE COMPANY, PETITIONER

versus

FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT

RP 74-20

On Petition for Review of An Order of the
Federal Energy Regulatory Commission

ON PETITION FOR REHEARING

(August 8, 1979)

Before BROWN, Chief Judge, COLEMAN
and TJOFLAT, Circuit Judges.

PER CURIAM:

IT IS ORDERED that the petition for rehearing filed in the above entitled and numbered cause be and the same is hereby denied.

ENTERED FOR THE COURT:

/s/ Judge Coleman
JUDGE COLEMAN
Chief Judge

APPENDIX D

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Opinion No. 815-A

Docket Nos. RP74-20
RP74-83

UNITED GAS PIPE LINE COMPANY

OPINION AND ORDER ON REHEARING

Issued: November 15, 1977 DC-B-13

SMITH, Commissioner:

On October 1, 1977, pursuant to the provisions of the Department of Energy Organization Act (DOE Act), Public Law 95-91, 91 Stat. 565 (August 4, 1977) and Executive Order No. 12009, 42 Fed. Reg. 46267 (September 15, 1977), the Federal Power Commission * ceased to exist and its functions and regulatory responsibilities were transferred to the Secretary and the Federal Energy Regulatory Commission (FERC) which, as an independent commission within the Department of Energy, was activated on October 1, 1977.

The "savings provisions" of Section 705(b) of the DOE Act provide that proceedings pending before the FPC on the date the DOE Act takes effect shall not be affected and that orders shall be issued in such proceedings as if the DOE Act had not been enacted.

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* The "Commission", when used in the context of an action taken prior to October 1, 1977, refers to the FPC; when used otherwise, the reference is to the FERC.

All such proceedings shall be continued and further actions shall be taken by the appropriate component of DOE now responsible for the function under the DOE Act and regulations promulgated thereunder. The functions which are the subject of these proceedings were specifically transferred to the FERC by Section 402(a)(1) of the DOE Act.

The joint regulation adopted on October 1, 1977 by the Secretary and the FERC entitled "Transfer of Proceedings to the Secretary of Energy and the FERC," 10 CFR ——, provided that this proceeding would be continued before the FERC. The FERC takes action in this proceeding in accordance with the above mentioned authorities.

In Opinion No. 815, issued on July 29, 1977, the Commission considered a Stipulation and Agreement certified by the Presiding Administrative Law Judge as a settlement of many rate issues involved in this consolidated proceeding. According to the terms of the Stipulation and Agreement, three rate issues were reserved by the parties for decision by the Commission. A hearing was held on these issues, the record of which was certified by the Presiding Judge together with the Stipulation and Agreement. Comments filed in response to the Presiding Judge's certification focused upon the reserved issues.

United Gas Pipe Line Company (United) filed an application for rehearing on August 29, 1977,[1] asserting that the Commission erred in three respects in

[1] "United Gas Pipeline Company's Application for Rehearing and Clarification," *United Gas Pipeline Co.*, Docket Nos. RP74-20 and RP74-83, August 29, 1977. (United's App.).

ruling upon the proffered settlement. First, United claims that the Commission's disallowance of $23,380,650 in front-end advance payments from rate base treatment was erroneous. Second, United asserts that the Commission erred in remanding the question of proper cost of service treatment for United's so-called "interest reimbursement" payments to producers. United suggests that all relevant facts have been developed on the instant record, such that the ordered remand is unnecessary and the underlying question of proper cost of service treatment for these payments is now ripe for decision. Third, United claims that the Commission unlawfully imposed a refund interest rate of 9% in the face of an allegedly clear agreement by affected parties that an interest rate of 7% would obtain. Additionally, United asks that certain clarifications be made.

The Public Service Commission of the State of New York (New York) and Laclede Gas Company (Laclede)[2] petitioned for rehearing of the Commission approval of the submitted Stipulation and Agreement as just and reasonable without resolution of a challenge to the stipulated rate of return.[3]

[2] "Petition for Rehearing of the Public Service Commission of the State of New York," *United Gas Pipeline Co.*, Docket Nos. RP74-20 and RP74-83, August 29, 1977. (N.Y. App.); "Application of Laclede Gas Company for Rehearing," *United Gas Pipe Line Co.*, Docket Nos. RP74-20 and RP74-83, August 29, 1977 (Laclede's App.).

[3] On July 28, 1976, Laclede filed a pleading with the Commission which set forth certain allegations and tendered a motion requesting that the record be reopened for consideration of its new challenge to an element of the certified Stipu-

I. *Advance Payments.*

As United admits (*United's App.* pg. 3), rate base treatment for monies advanced by the company to producers is determined by an application of the "reasonable and appropriate" standard. United argues that this standard means, or should mean, that the disputed advance payments were prudently made when judged by standards of sound business judgment. United asserts error in this Commission's use of a thirty-day test of reasonableness in this case as bearing no rational relationship to United's business judgment. The company claims that the facts conclusively indicate that, at the time United committed itself to the disputed advance payments, its advances, even though front-end,[4] were reasonable,

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lation and Agreement. "Supplemental Comments of Laclede Gas Company . . . And Motion To Reopen Record," Docket Nos. RP74-20 and RP74-83, July 28, 1976. Laclede's motion was supported by Brooklyn Union Gas Company. The motion was denied by operation of law under the Commission's Regulations. *See* 18 C.F.R. § 1.12(e).

New York on rehearing argues that Section 1.12(e) of the regulations is not a bar to Commission action on the substance of Laclede's complaint, since this case is still before the Commission. New York is correct in this assertion and to the extent that Laclede's application for rehearing can be considered to be a challenge to the merits of Opinion No. 815, the substance of its position will be considered. *See,* Part IV, *infra.*

[4] United does not suggest that any particular benefit to consumers is conferred by the front-end nature of the advances. It merely argues that anticipated attachment of new reserves pursuant to its advance payment agreements is a benefit. Where the pipeline can show that benefits flows from a front-end (or lump sum) advance, such as where the overall cost of the advance will be less because front-end in character,

appropriate and prudent. Therefore, United asserts that these front-end advance payments should be accorded rate base treatment in this case, and that it was error for the Commission to refuse such treatment.

United seeks to substantiate its construction of the "reasonable and appropriate" standard, as distinguished from the Commission's construction, by claiming that the Commission's use of the thirty-day rule of thumb is a retroactive application of a new rule. Jurisdictional pipelines are responsible in rate increase proceedings for justifying both the amount and the prudence of any expenditures that they seek to recoup from their customers. Our conclusion that a portion of United's advance payments at issue in this proceeding are unreasonable and inappropriate costs for ratemaking purposes reflects nothing more than our judgment on the record that the carrying cost of the advances challenged in this case should not be borne by United's consumers. The Commission has not announced a new rule and applied it retroactively.

In determining whether the challenged advances were reasonable and prudent, the Commission considered Commission staff's argument that advances which were not required by the agreement of the parties to be expended by the recipient producer within thirty days of the end of the locked-in period during which these rates were effective could not be

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we have stated that current rate base treatment would be appropriate. *See, e.g., Tennessee Gas Pipeline Company,* Opinion No. 769, 55 F.P.C.—*mimeo,* pg. 33.

considered reasonable and prudent because these costs were not presently beneficial to United's customers. Staff had argued that no more than 30 days would be reasonable to allow producers to expend advanced monies in hand on current exploration and development activity. Otherwise, argued staff, the monies invested would support no current benefit in increased exploration and development for the pipeline's customers. Our acceptance of this argument as the only persuasive one presented in this record in deciding the question of reasonableness does not erect a retroactive rule. We have consistently indicated that the rate treatment for advance payments will be decided on a case-by-case basis.

On the merits, United states that other evidence in the record should have been considered in determining whether the particular advances were reasonable and prudent. United suggests, for example, that the superior bargaining position of producers during the period of the experimental advance payment program allowed these recipients to dictate the terms of advance payment agreements. United argues that producers *required* front-end advance payment agreements. In effect, United argues that it had no choice in negotiating more favorable terms for advance payments and, considering its critical need for the commitment of additional reserves, the reasonable and prudent course for the company was to have accepted the producers' preconditions rather than to have refused to enter any advance payment agreement at all.

Under our advance payment program as originally conceived, advances that were expended for exploratory activities by producers benefited the customers who were asked to bear the carrying cost of this expenditure through rate base treatment of the invested monies. On the other hand, unexpended advances cannot be considered presently used or useful investment by the pipeline and, accordingly, cannot be considered a benefit to the *present* customers who will pay current rates. It follows that, on the basis of these settled rate-making principles, rate base treatment for advance payments must be deferred until such advances are expended for purposes for which they were extended by the pipeline. None of the advance payments orders[5] indicated that this experimental program would waive the traditional ratemaking requirement that costs passed on to consumers must be presently useful in service to the public.

The Commission's advance payment program was developed with a specific objective in mind. The creation of this experimental program did not grant *carte blanche* to pipelines to flow-through any expense to their customers, even though their expenditures may ultimately result in the attachment of new

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[5] *See, FPC Order No. 410,* 44 F.P.C. 1142 (October 2, 1970); *FPC Order No. 441,* 46 F.P.C. 1178 (November 10, 1971); *FPC Order No. 465,* 48 F.P.C. 1550 (December 29, 1972); and *FPC Order No. 499,* 50 F.P.C. 2111 (December 28, 1973). In the instant case each of the advance payments involved were made pursuant to *FPC Order No. 465, supra,* with the exception of two which are governed by *FPC Order No. 499, supra.*

reserves to the benefit of the company's customers. The "reasonable and appropriate" standard applied here is simply a restatement of this Commission's statutory obligation to review all pipeline expenditures in order to determine their prudence. We do *not* find that, as a matter of business acumen, United was unwise to enter into front-end advance payment agreements. We find only that under settled ratemaking practices these particular expenditures by United were of no present benefit to its customers during the locked-in period involved in this case. Therefore, rate base treatment to recover the cost to United of unexpended advances must be deferred to some later rate proceeding in which United can prove a positive, present benefit through a showing that the recipient producers actually expended the interest-free capital for the purposes for which it was advanced.[6]

II. *Interest Reimbursements.*

In Opinion No. 815, the Commission remanded for further evidentiary proceedings the question of the proper cost of service treatment for United's interest payments to producers in lieu of standard advance

[6] In the attempt to increase exploration and development of natural gas reserves the Commission created an exception to the normal requirement that rate base investment be presently useful in the public service by essentially defining those advance payments *serving the specified objective of the program* to be presently "used and useful." Since unexpended advances do not serve the purpose which was intended under the advance payment program, such advances cannot be considered as part of this exceptional category, absent a convincing showing of significant benefits to customers associated with the unexpended advance.

payments. United claims that this remand was improper because the additional facts which we stated to be required for decision on the merits of this question are irrelevant to the decision.

The Commission held that United's alternative to advance payments reimbursement of the actual interest expenses of producers, must, for ratemaking purposes, be judged under the same standard that applies to conventional advance payments. The costs associated with this interest reimbursement program must, therefore, be found "reasonable and appropriate" in order to be recovered through the instant rates. We are unable to determine whether these costs are reasonable, appropriate and prudent in the absence of evidence as to the *expenditure of the capital* upon which the interest was advanced by United. This capital must have been dedicated for the purposes intended by the advance payment program and during the period in which the instant rates were effective in order for it to be found by the Commission that the costs to the pipeline relate to an activity which is of present benefit to United's ratepayers, albeit that tangible results of the investment will not be seen for several years. There is no evidence in this record which indicates how the reimbursed producers expended their self-procured capital. United bears the burden of proving that this capital investment actually benefited its (United's) current ratepayers in the manner envisioned by the advance payment program. It has not done so on the present state of the record, and it was not improper for the Commission, given the remand in *United Gas Pipe*

Line Co. v. *FPC*, 551 F.2d 460 (D.C. Cir. 1977), to provide the company with an additional opportunity to sustain its burden in this case.[7]

III. *Stipulated Refund Procedures and Interest.*

United requests clarification of Opinion No. 815 as to the applicability of the refunded procedures agreed upon by the parties in negotiating the Stipulation and Agreement. Refunds should indeed be calculated according to the procedures outlined in the Stipulation. *See, Opinion No. 815,* Ordering Paragraph (B), pg. 18. United shall also file revised tariff sheets with the Commission, which revised tariffs shall reflect the mandate of this Opinion. Ordering Paragraph (E) will be triggered by the payment of refunds by United. In those areas where a final decision as to refund liability is contingent upon the outcome of another proceeding or a remanded proceeding, United shall make any required refund according to the procedures set forth in the Stipulation and Agreement. An additional compliance report, as required by Ordering Paragraph (E), shall be filed within 15 days of any such subsequent

[7] United states that "because the producer's actual interest cost under such [reimbursement] arrangements was less than the return which would accrue on a comparble advance payment, the interest reimbursement agreements offered cost advantages to United's customers. *United App.*, pg. 9. At hearing on this remanded issue United has the opportunity to show that these alleged "cost advantages" themselves justify cost of service treatment for its interest payments to producers, even though it might be shown that the underlying capital was not expended by the recipient-producers during this locked-in period. *Compare,* n.4, *supra.*

refunds. This procedure obviates any need for the Commission to independently review revised tariffs and calculated refunds to insure conformance with the mandate of this Opinion. Therefore, Ordering Paragraph (D) of Opinion No. 815 shall be vacated as unnecessary to insure orderly refunds. It is, of course, understood that any refunds will bear the rate of interest determined to be appropriate by the Commission in this proceeding.

With respect to the appropriate rate of interest on the refunds which are now, or may subsequently become, payable by United, the company assigns error in the Commission's determination that an interest rate of 9%, rather than that of 7% as mentioned in the Stipulation and Agreement, is required under applicable Commission regulations. The rates involved in this proceeding were collected by United from April 6, 1974 through May 19, 1975. The Commission's determination that a rate of interest of 9% will apply to refund liability, consistent with the Commission's regulations, should be understood to apply only to those amounts collected on or after October 10, 1974, including all interest accruing on or after that date on refundable amounts collected prior to that date. An interest rate of 7% shall apply to amounts to be refunded that were collected prior to this date.

With respect to the refundable amounts collected after October 10, 1974, United assigns error in the Commission's finding that there is "no evidence to indicate [that] the interest rate was bargained for as an integral and key part of the settlement. . . ."

Opinion, pg. 16. For settlement agreements filed after December 6, 1976, the interest rate on refunds is not a negotiable item. *See*, "Order Denying Rehearing and Further Clarifying Order No. 513-A," *Rate of Interest on Amounts Subject to Refund*, Docket No. RM74-18, December 6, 1976, pg. 5. The instant settlement, however, was negotiated and filed with the Commission during the era in which the interest on refunds was still a negotiable element in rate case settlements. The instant settlement was negotiated and filed with the Commission prior to the court's decision in American Public Gas *Gas Association* v. *FPC*, 546 F.2d 983 (D.C.Cir. 1976), although all parties to the instant settlement were presumably aware of the appeal of the Commission's *Order No. 513*. The standard which applies to all settlement agreements filed subsequent to October 14, 1974, and prior to December 6, 1976, is whether the filed settlement agreement on its face indicates that the stipulated interest rate was a bargained-for element of settlement. In this case, the instant agreement, while stipulating an interest rate of 7%, does not indicate that this stipulated rate was an integral part of the agreement reached. Consequently, the Commission applied the regulations, 18 C.F.R. § 154.67(c), absent any indication that this change would compromise the integrity of the settlement process. *See, Northern Natural Gas Co.*, Docket Nos. RP74-75, *et al.*, order issued July 27, 1976.

In *Natural Gas Pipeline Company of America*, Opinion No. 762-A, 5 — F.P.C.—(December 6, 1976), the Commission approved the use of the in-

terest rate stipulated in the proffered settlement agreement because the agreement itself indicated that the parties had bargained for the stipulated rate. Such indications are not apparent on the face of the instant Stipulation and Agreement. Thus, Opinion No. 762-A, *supra*, is distinguishable,[8] and the *Northern Natural* precedent, *supra*, controls. United's assignment of error is rejected.

IV. *Rate of Return.*

In its application for rehearing, Laclede renews its objection to the settlement rate of return. New York in its petition for rehearing objects to the Federal Power Commission's [FPC] failure in Opinion No. 815 to consider Laclede's rate of return arguments and rule thereon. The facts and circumstances giving rise to the controversy over the settlement rate of return are as follows:

At the time the settlement in these proceedings was certified to the FPC by the Presiding Law Judge on December 24, 1975, no party opposed the proposed settlement rate of return of 10.157 percent.[9] However, following the filing of initial comments on the proposed settlement, Laclede, on July 28, 1976, filed supplemental comments with the FPC, noting that in United's succeeding rate proceeding in Docket No.

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[8] *See also* "Order Approving Settlement Agreement," *Appalachian Power Co.*, Docket No. E-7775, November 2, 1976.

[9] The capital structure for the period includes, $224,680,708 of debt at a cost of 8.9 percent, $100,000,000 of preferred stock at 9.75 percent, and $84,128,835 of common equity at 14 percent.

RP75-30 the FPC staff had taken the position that the $100 million of United's preferred stock should be included in its capitalization at zero cost as a result of the FPC's order of November 28, 1975, in the so-called Pennzoil spin-off case in Docket No. RP74-87.[10] Laclede requested that the FPC staff be directed to institute an inquiry into the rate of return issue in light of the spin-off agreement, and requested that the record in these proceedings be reopened for the purpose of such inquiry. Brooklyn Union joined in support of Laclede's request. In Opinion No. 815 the FPC approved the settlement rate of return without discussion and treated the request of Laclede and Brooklyn Union as having been denied by operation of law pursuant to 18 CFR 1.12(e).

In their applications for rehearing, Laclede and New York request the Federal Energy Regulatory Commission (FERC) to make the settlement rate of return in these dockets subject to adjustment based upon the Commission's ultimate disposition of the

[10] On March 13, 1974, United, then a subsidiary of Pennzoil Company, transferred $100 million from its common equity accounts to open its preferred stock account. On March 14, 1974, United was spun-off from its parent company and one million shares of United's preferred stock, $100 par value, at 9.75 percent were issued to Pennzoil. The FPC initiated an investigation of the spin-off, which culminated in the FPC's order of November 28, 1975, approving a settlement agreement resolving the controversy. Under the terms of the settlement, the preferred stock issue was rescinded, Pennzoil agreed to return the dividends paid by United on the preferred stock, and United agreed to repay certain capital contributions Pennzoil had made to United at the time of the spin-off.

preferred stock issue in Docket No. RP75-30.[11] United would be required to make additional refunds in the event the Commission's decision on the preferred stock issue in Docket No. RP75-30, when applied in this case, were to result in a rate of return lower than the settlement rate of return of 10.157 percent.

Upon review of the applications for rehearing of Laclede and New York, it is concluded that the issue concerning the proper treatment of United's preferred stock should be considered and decided by the Commission in determining the reasonableness of the settlement rate of return in these proceedings. *Placid Oil Company* v. *FPC*, 483 F.2d 880 (5th Cir. 1973), *affirmed*, 417 U.S. 283 (1974).[12] However, upon review of the matter the Commission has determined that the present record does not contain substantial

[11] The preferred stock issue was fully litigated in Docket No. RP75-30. The Presiding Judge's initial decision in that case was issued on October 14, 1977, and the matter will be before the Commission for decision following the filing of briefs on exceptions to the initial decision and briefs opposing exceptions.

[12] In the *Placid Oil* case, the court states as follows 483 F.2d 893:

> ". . . If a proposal enjoys unanimous support from all of the immediate parties, it could certainly be adopted as a settlement agreement if approved in the general interest of the public. But even if there is a lack of unanimity, it may be adopted as a resolution *on the merits*, if FPC makes an independent finding supported by 'substantial evidence on the record as a whole' that the proposal will establish 'just and reasonable' rates. . ." (Emphasis by the Court).

See also, *Georgia Power Company*, Docket Nos. E-7548, *et al.*, 52 FPC 1343, 1351 (1974).

evidence directed to the issue of the proper classification of the preferred stock such as would permit the Commission to decide the issue on its merits in these proceedings. Under these circumstances, the Commission finds that the suggestion of Laclede and New York proposing that the resolution of preferred stock issue in these proceedings be governed by the Commission's ultimate determination of the same issue in Docket No. RP75-30 is reasonable and shall be adopted.[13] Accordingly, this deferred question will be severed from the instant docket and consolidated for purposes of decision with the proceeding in Docket No. RP75-30.

United shall be permitted to determine its settlement rates in these dockets using the settlement rate of return of 10.157 percent. However, United, may be obligated to make additional refunds in the future should the Commission so determine in its decision in Docket No. RP75-30.

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[13] The "preferred stock issue" to which we refer is limited to the determination of the impact of the Pennzoil-United spin-off Settlement upon the proper classification of the $100 million of capital for purposes of ratemaking. We do not intend to imply that the separate issue of the cost to be assigned to this increment of United's capital will be subject to our decision in Docket No. RP75-30, for the parties to the instant proceeding have stipulated by settlement an agreeable rate of return. The sole issue deferred at this time—and the limit of the refund liability created *sua sponte* by the Commission at this time—involves the question of how excessive, if at all, is the 10.157% return incorporated as a part of the instant Stipulation and Agreement.

The Commission finds:

(1) The instant record is inadequate to render a decision on the merits of Laclede's contention that the 10.157% rate of return set forth in the Stipulation and Agreement is excessive.

(2) The question of the proper classification of $100 million of United's capital, which was costed in the Stipulation as if this capital were preferred stock bearing a dividend of 9.75% per annum, is presented in another proceeding presently before the Commission in Docket No. RP75-30, and the issue has been fully litigated therein.

(3) It is appropriate and in the public interest to defer decision on the merits of the issue as stated in (2), *supra*, until the record in Docket No. RP75-30 is before the Commission for decision on the merits.

(4) No potential refund liability or procedures having been stipulated by the parties to the Stipulation and Agreement for refunds which might be occasioned by a decision holding the stipulated rate of return excessive, it is in the public interest for the Commission to create such potential refund liability in the event that it is subsequently determined in Docket No. RP75-30 that the rates herein approved are excessive and unreasonable.

(5) In all other respects the assignments of error and grounds for rehearing set forth in the applications filed by the parties to this proceeding present no additional facts or legal arguments which would warrant any change in or modification of Opinion No. 815, and the accompanying order, except as such order has been clarified in this Opinion.

The Commission orders:

(A) The issue of the proper classification of $100 million of United's capitalization during the instant locked-in period and the subsidiary question of the reasonableness of the 10.157% rate of return set forth in the Stipulation and Agreement in this case are hereby severed from the instant proceeding and consolidated for purposes of decision and consolidated for purposes of decision with the proceeding Docket No. RP75-30, which is presently pending Commission decision on the merits.

(B) Parties affected by the instant severance and consolidation may file supplementary comments to the instant settlement, in Docket No. RP75-30, on or before December 7, 1977, setting forth any arguments or observations which may distinguish our reserved decision on the merits of the rate of return question in this case from the similar, if not identical, issue presented in Docket No. RP75-30. Such supplemental comments shall be independent from any exceptions filed in Docket No. RP75-30, to the initial decision issued in that docket on October 14, 1977.

(C) The rates approved in this Opinion are approved as just and reasonable, subject to a further refund liability if it is subsequently found that the 10.157% return incorporated in the instant Stipulation and Agreement is excessive or unreasonable.

(D) Upon rehearing, the Stipulation and Agreement is approved as reasonable, subject to the mandate and decision of the Commission in Opinion No. 815, as clarified in the present order, and further

subject to the limited, potential refund liability created in (C), *supra.*

By the Commission.

[SEAL]

KENNETH F. PLUMB,
Secretary.

APPENDIX E

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Docket Nos. RP74-20
RP74-83

OPINION No. 815

OPINION AND ORDER ON RESERVED ISSUES AND OTHERWISE APPROVING SETTLEMENT AGREEMENT

Before Commissioners: Richard L. Dunham, Chairman; Don S. Smith, and John H. Holloman III.

(Issued July 29, 1977)

SMITH, Commissioner:

This case involves the reasonableness of a proposed Stipulation and Agreement negotiated between United Gas Pipe Line Company (United), various of its jurisdictional customers [1] and the Commission staff.

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[1] By order isued November 6, 1973, in Docket No. RP74-20 intervention was granted the following parties: Memphis Light, Gas and Water Division; Public Service Electric & Gas Co.; Laclede Gas Co.; Arkansas Louisiana Gas Co.; United Gas, Inc. (now Entex, Inc.); New Orleans Public Service Inc.; Southern Natural Gas Co.; Florida Gas Transmission Co.; Pub. Service Com'n of the State of New York;

The procedure adopted below resulted in the proffer of the proposed settlement and the development of an evidentiary record at hearing on several reserved issues covered in the proposed Stipulation and Agreement. The record and Stipulation comes before us upon certification by the Presiding Administrative Law Judge without recommendation.

Procedural History

On September 21, 1973, United filed a proposed increase in its FPC gas tariff in Docket No. RP74-20 which would increase jurisdictional revenues by approximately $34.9 million. On November 6, 1973, the Commission accepted these increased rates for filing, suspending their effectiveness until April 6, 1974. On April 15, 1974, United filed an additional rate increase in Docket No. RP74-83 which would result in a further increase in jurisdictional revenues of approximately $92.9 million. By order of May 16, 1974, these latter rates were accepted by the Com-

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Mississippi Valley Gas Co. and Mobile Gas Service Corp.; the State of Louisiana; Mississippi River Transmission Corp.; Natural Gas Pipeline Co. of America; Willmut Gas & Oil Co.; Philadelphia Gas Works; Consolidated Gas Supply Corp.; United Municipal Distributors Group (MDG); Texas Gas Transmission Corp.; Algonquin Gas Transmission Co.; and Texas Eastern Transmission Corp.

On December 12, 1973, intervention was granted Philadelphia Electric Co., Mid Louisiana Gas Co., Louisiana Gas Service Co. and Columbia Gas Transmission Corp. Moreover, on July 31, 1974, the Alabama Public Service Commission was granted intervention with Mississippi Public Service Com'n granted intervention on March 6, 1975.

mission, subject to refund, to become effective on November 1, 1974. These two separate proposals were consolidated for purposes of hearing and decision.

In Docket No. RP75-30 United filed for a further rate increase which became effective, subject to refund, on May 20, 1975. Thus, the instant proceeding on the lawfulness of the proposed rates is concerned solely with the "locked-in" period between April 6, 1974, and May 19, 1975.

Settlement negotiations ensued between United, Commission Staff and various of United's customers affected by the proposed increased rates. These negotiations resulted in a proposed Stipulation and Agreement which was apparently circulated by United on August 1, 1975, but is unsigned by any party. By agreement of the parties to this stipulation, a procedural schedule was established for the submission of testimony and evidence regarding this settlement proposal and for a hearing to be held on certain reserved issued on December 2, 1975.

On December 2, 1975, witnesses appearing on behalf of United and Commission staff were presented for cross-examination before Presiding Administrative Law Judge Graham W. McGowan. Subsequent to this hearing, on December 24, 1975, Presiding Judge McGowan certified the unsigned proposed Stipulation and Agreement (Exhibit A) and the evidentiary record developed by the parties to the Commission. This certification was noticed by the Commission's Secretary on January 13, 1976. 41 FR 3141.

Comments pursuant to this notice were filed by Entex, Inc., Natural Gas Pipe Line Co. of America, Texas Gas Transmission Corp., Mississippi River Transmission Corp., Texas Eastern Transmission Corp., the United Municipal Distributors' Group (MDG), Commission staff and United. Reply comments were filed by United and the State of Louisiana. No parties objected to the settlement although adverse positions with respect to the reserved issues were taken by certain parties as detailed below.

Subsequent to certification on June 15, 1976, the United Municipal Distributors' Group (MDG) petitioned the Commission with a request that any refunds found appropriate in this case "be assessed at a 9% interest rate from October 10, 1974, forward rather than at the 7% interest provided for in the Stipulation and Agreement herein. . . ." *Petition*, pg. 1. On the authority of *American Public Gas Ass'n.* v. *FPC*, —— F.2d ——, (D.C. Cir. 1976), CADC No. 75-1104, (May 19, 1976), MDG argues that, as a matter of law, the settlement must be revised to reflect the alleged lawful interest rate. This petition was noticed in the *Federal Register* (41 FR 27876) on July 7, 1976. On July 9, 1976, United filed an answer in opposition to the relief requested by MDG's Petition, stating that the parties negotiating this settlement did not make the stipulated interest rate of 7% contingent in any fashion on the outcome of the *APGA* appeal whereas when an item was contingent upon the outcome of another proceeding the parties expressly so provided, and that

any stipulated interest rate (7%) is a "significant factor" in any rate proceeding. *Answer*, pg. 3 MDG's request is addressed on its merits in Part III of this Opinion, *infra*.

Moreover, on July 28, 1976, Laclede Gas Company (Laclede) filed supplemental comments to the instant settlement agreement and requested that the record be reopened to give further consideration to the Agreement's stipulated rate of return in light of other developments. On August 9, 1976, Brooklyn Union Gas Company joined in Laclede's motion. United responded to Laclede's motion on August 12, 1976, opposing the reopening and stating that movants had failed to demonstrate good cause therefor under applicable Commission regulations. See, 18 C.F.R. § 1.33. Laclede's motion was denied by operation of law on August 27, 1976. *See*, 18 C.F.R. § 1.12(e).

The Proposed Stipulation and Agreement

Cost of Service. The parties to the proposed Stipulation and Agreement have agreed that United's jurisdictional cost of service for the locked-in period should be based on the twelve months actual operating experience ended April 30, 1975. The jurisdictional cost of service was agreed to be $422,160,271, based upon jurisdictional sales volumes of 741,234,988 Mcf at 14.73 psia. During this period, it was further stipulated, United collected from its jurisdictional customers' revenues in the amount of $428,018,396. *See, Exhibit A*, Appendices A and A-1.

Refunds. The parties have agreed that the refund amount is 0.79032¢ per Mcf of jurisdictional sales volumes during the locked-in periods and that during the period the jurisdictional sales volumes is 822,545,012 at 14.73 psia, leaving a refund amount of $6,500,738. The parties have agreed to a 7% annual interest rate to accrue monthly until refunds are paid.

Reserved Issues

I. *Purchased Gas Cost.* The stipulated jurisdictional cost of service reflects $72,906,838 of purchased gas costs attributable to 134,578,270 Mcf of currently noncertificated purchases (at an average price of 54.17¢ per Mcf) which United alleges are not jurisdictional producer sales under the Natural Gas Act. Commission staff regards this item of expense excessive by $8,752,329, representing the difference between the price paid by United for this supply and the price determined "just and reasonable" under the Commission's applicable national rate. Under the proposed Stipulation and Agreement, however, United has assumed no obligation to refund any portion of these purchased gas costs "unless some or all of the producers making such non-certificated sales to United shall be required by order of the Federal Power Commission, in any proceeding involving such producers, to refund some portion of the amounts received during the refund [locked-in] period for such gas sales to United." Exhibit A, Art. II, pg. 8-9. The parties have agreed that in the event of a refund to United by these producers United itself would refund 81.5%

(the allowable jurisdictional portion thereof) of such refunds from producers by crediting its Deferred Purchased Gas Cost Account.

II. *Advance Payments.* The proposed Stipulation indicates a cost of service item representing the effect of rate base treatment of advance payments in the aggregate amount of $79,238,960. These various advances are classified into three severable groups under the stipulation. *See, Exhibit A* Appendix E.

(A) The parties have agreed to no refund liability for those advances which are listed in Part A of Appendix E. All parties apparently concur that these payments were "reasonable and appropriate" under outstanding Commission orders. *See, FPC Order No. 465*, 48 F.P.C. 1550, 1555, (1972); *FPC Order No. 499*, 50 F.P.C. 2111, 2115 (1973), *reh. denied*, 51 F.P.C. 818 (1974).

(B) In Part B of Appendix E of the proposed Stipulation advances in the amount of $65,150,718 are covered. Commission staff suggests that only $41,770,071 of this expense is "reasonable and appropriate," and, therefore, that United's cost of service be reduced by $23,380,647. According to the proposed Stipulation United has agreed to remove each advance listed in Part B to the extent it is finally determined that its recipient "will fail to make expenditures at least equal to the amount advanced by United" in conformance with the terms and purposes for which the particular advance was made, and to refund such excluded amounts to the jurisdictional customers for the instant locked-in period.

It is apparent from a reading of the proposed stipulation that the parties consider failure to expend the full amount advanced by United for the purposes leading to the advancement is the single event which would trigger United's refund obligation with respect to these advances. Staff challenges the reasonableness of this provision on the merits under applicable law.

(C) With respect to United's 50% interest in an advance payment to TransOcean Oil, Inc., which it received in an exchange with Southern Natural Gas Co. for an assignment of a 50% interest to Southern in advance payment agreements with ECEE, Inc. and Pinto, Inc., the parties have agreed that rate base treatment of these amounts—listed in Part C of Appendix E to the Stipulation—shall be governed by the final decision, no longer subject to judicial review, of the issue in Docket Nos. RP72-91, *et al.* The parties to this proceeding do not contest the reasonableness of this stipulation.

III. *Interest Payments to Producers.* Under the proposed Stipulation and Agreement the parties have agreed on $48,893,330 of other operation and maintenance expenses. Exhibit A, Appendix A. Commission staff challenges this amount as excessive by $1,644,956, this amount representing the cost of interest reimbursement by United on loans to producers to finance exploration and production ventures.

IV. *Income Tax.* The parties have stipulated $18,892,596 as the federal income tax expense in

United's total cost of service. Exhibit A, Appendix A. MDG challenges this stipulated figure as excessive by an indeterminate amount by virtue of United's alleged tax savings during the test period resulting from the use of consolidated federal income tax filings.

NON-CONTESTED ISSUES

The total cost of service agreed upon by the parties reflects $30,714,948 of purchased gas costs (84,257,-859 Mcf at an average price of 36.45¢) from producers holding small producer exemptions. *See*, Order No. 428, 45 F.P.C. 454 (1971), as amended. The parties have agreed that United shall collect the full amount of these costs, subject to possible refund in the event that the pipeline is required to refund any part of these costs incurred during the test period. *See*, Opinion No. 742, 54 F.P.C.—(August 28, 1975), *aff'd*, Opinion No. 742-A, 55 F.P.C.—(July 27, 1976), where small producer refunds were only required prospectively from July 27, 1976.

The total cost of service also reflects $8,535,315 of purchased gas (13, 928,064 Mcf at an average price of 61.28¢) classified as emergency purchases by United. *See*, Order No. 491, 50 F.P.C. 742 (1973), *rev'd, Consumer Federation of America*, 515 F.2d 347 (D.C. Cir. 1975). The parties have agreed that the full cost of these emergency purchases shall be collected by United, subject to possible refund if the company is ordered to refund any portion of these

costs for the refund period by final Commission order in Docket No. RP72-133.

DISCUSSION

I.

Commission staff and MGD challenged United's purchased gas costs as excessive. They contend the producers from whom United purchased this gas are actually jurisdictional and that United has unlawfully included in its cost of service the full, actual cost of its purchased gas rather than excluding the cost of gas purchased from non-certificated producers above the applicable area or national rate. The Commission staff argues "that the payments in excess of the national rate which United paid to the [allegedly non-jurisdictional] producers . . . should not be recoverable from the jurisdictional ratepayer." *Staff comments*, pg. 10. MDG generally echoes staff's argument on this issue.

There is no question that United actually paid the full amount for its purchased gas which is included in its cost of service and which is now challenged as excessive.

Commission staff and MDG argue that, as a matter of law, any pipeline sale for resale out of a commingled supply requires that the pipelines purchase price of any element of that commingled supply be limited to the federally regulated rate in the interest of full and complete protection of the jurisdictional consumer. United responds that the Act explicitly

limits the Commission's authority to regulate the price of natural gas which is not sold "in interstate commerce," 15 U.S.C. § 717(b), and that sales "in" interstate commerce require that the purchased gas, even if commingled with gas imported from another state, must subsequently cross a state line. In the instant case the parties seem to agree that United's purchases within Louisiana will not, subsequent to purchase and commingling with interstate gas, pass into another state. If we were to accept the instant evidentiary record as an adequate factual predicate upon which to decide the jurisdiction of the Commission over the various sales indirectly challenged in this proceeding, these stipulated facts would bring this case within the ambit of *Colorado Interstate Gas Co.*, Opinion No. 777, 56 F.P.C.—(September 30, 1976). In that case the Commission decided, on similar facts, that producer sales were not jurisdictional even though the gas purchased was commingled with interstate jurisdictional supplies and ultimately sold to jurisdictional customers at federally-regulated rates. However, the instant proceeding is not the appropriate case in which to decide this jurisdictional question.

It is quite apparent that a decision on this issue requires a threshold finding of Commission jurisdiction over these non-certificated sales. This subsidiary finding is of great consequence to the respective producers as well as the purchasing pipeline, United. However, no producer selling to United at a price above the applicable national or area rate ceil-

ing has entered an appearance in this proceeding, and the Commission is wary of entering a final decision as to the jurisdictionality of these sales without first having the benefit of these producers' views. In cases such as this, the Commission is fully authorized to determine the appropriate case in which a particular issue will be addressed. *Fort Pierce Util. Authority* v. *FPC*, 526 F.2d 993, 999 (5th Cir. 1976). The Commission has an ongoing proceeding initiated pursuant to a staff motion in a separate docket requesting that the Commission institute a show cause proceeding to determine the jurisdictional issue upon which its objection is predicated in this proceeding.[3] In the exercise of our discretion, therefore, the Commission finds that it is appropriate to address the issue of the jurisdictional character of these presently non-certificated sales to United in Docket No. CP76-238.

An additional reason in support of the deferral of decision on this jurisdictional question is the fact that the rates at issue in this proceeding have, in large measure, been derived though settlement among the interested parties. The Stipulation and Agreement of the parties. (Exhibit A, pp. 8-9) provides that

> The parties to this Stipulation and Agreement agree that those costs incurred by United to purchase the gas from producers under sales

[3] *See*, "Order to Produce Data," *United Gas Pipeline Company & Certain Producer Respondents*, Docket No. CP76-238, issued January 25, 1977.

> which have not been certificated are to be included in their entirety in United's cost of service for the Refund Period. United shall have no obligation to refund any portion of such purchased gas costs to any of its customers unless some or all of the producers making such non-certificated sales to United shall be required by order of the Federal Power Commission, *in any proceeding involving such producers*, to refund some portion of the amounts received during the refund period for such gas sales to United. In the event that such refunds are required and are ultimately made to United by the producers, United agrees that it shall refund the jurisdictional portion of such amounts which it actually receives to its jurisdictional customers.

This contingent refund obligation assumed by United will fully protect its jurisdictional ratepayers in the event that the Commission ultimately determines in Docket No. CP76-238 that the non-certificated producer sales are, and have been, jurisdictional and bound by the applicable national or area rate ceiling. Since the only ground upon which Commission staff and MDG object to the inclusion of this expenditure for purchased gas by United is the difference in cost levels which would result from finding that these producers were bound by the federally regulated rate ceiling, it is clearly in the public interest to approve the instant settlement rates, as they are subject to a contingent refund obligation upon United in respect to excessive purchased gas costs.

II.

Recently, in *United Gas Pipe Line Co.* v. *FPC*, 551 F.2d 460 (D.C. Cir. 1977), the Circuit Court of Appeals for the District of Columbia reversed this Commission's summary exclusion of certain interest reimbursements by United to producers which were alleged by the pipeline to be a permissible alternative to the advance payments authorized by Commission regulations.[4] In so ruling, the court construed the various Commission orders establishing the experimental advance payments program.

> [W]e have found nothing in the Commission's orders setting up the advance payment program to indicate that the producers who were given such payments had to demonstrate an actual *need* for them. It is apparent that the Commission instituted the advance payment program merely as a means to enhance significantly the supply of natural gas in the interstate system during a period of critical nationwide gas shortages. It declared that the program was expected to intensify the development of new sources of natural gas supplies and thus alleviate the supply shortage, but it never expressly mandated that a producer show that *but for* the advance payments it

[4] *See, FPC Order No. 410*, 44 F.P.C. 1142 (October 2, 1970); *FPC Order No. 441*, 46 F.P.C. 1178 (November 10, 1971); *FPC Order No. 465*, 48 F.P.C. 1550 (December 29, 1973); and *FPC Order No. 499*, 50 F.P.C. 2111 (December 28, 1973). In the instant case each of the advance payments involved were made pursuant to *FPC Order No. 465, supra*, with the exception of two which are governed by *FPC Order No. 499, supra*.

> would not be able to obtain the necessary exploration and development capital. We think it unreasonable for the Commission now to adopt such a standard for United's interest reimbursement arrangements when they apparently constitute an alternative means for attaining the same goal as the Commission's own advance payment program. (*United supra*, at pg. 464, footnotes omitted).

Implicitly, the court found it unreasonable without a previously expressed mandate to impose a standard of need for advance payments by producers for *both* standard advance payments and for "an[y] alternative means for attaining the same goal." In the instant case, both advance payments and interest reimbursements [5] made by United are in issue. While a hearing was had on both of these issues such that the question of summary disposition is not involved in these proceedings, our decision on each of these issues is rendered with deference to the court's partial construction of our advanced payment orders.

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[5] On April 5, 1977, United filed with the Commission a motion requesting that the Commission consider the *United* decision, *supra*, in its disposition of the issues at bar in the instant dockets. This motion was responded to by Laclede on April 18, 1977. Laclede does not oppose the procedure suggested in United's motion but notes that an issue with similar multidocket ramifications is presented by the return to be allowed on United's preferred stock. While United's motion was technically deemed denied under Commission Regulations, the Commission will, of course, take cognizance of any relevant pronouncements of law in considering the issues involved in this case.

(A) *Advance Payments.*

The Commission's advance payments experiment was an attempt to stimulate exploration and development by the producers of natural gas by permitting interest-free loans from jurisdictional pipelines. The advance payment regulations created the impetus for interstate pipelines to advance capital to producers by permitting the pipelines to include the carrying charges of these loans in their respective rate bases. In a series of Commission orders which first established, and then refined, the advanced payment program, the Commission undertook to define the legal standard which would govern whether any particular advance payment to a producer would qualify for rate base treatment. The controversy in this as well as other recent cases dealing with advance payments relates to *when* the particular advances are to be properly included in the company's rate base, rather than *whether* such items of expense are ever to be reflected in rate base.

Commission staff has consistently taken the position that all advance payments must be related in both time and amount to the respective producer-recipient's need for such capital. Upon this theory, Commission staff has developed a thirty-day rule, holding in effect that any advance payment which is not expended by the producer-recipient within thirty days of the date the rates become effective [end of a locked-in period] in a particular rate case is front-ended and improperly reflected in the rate base of the

pipeline for recovery from its consumers through the particular rates in issue. The Commission has refused to adopt the Commission staff's thirty-day rule as the measure of the reasonableness and appropriateness of any particular advance, opting instead to decide the issue on a case-by-case basis which will appreciate the particular factual context within which each advance payment was made. In the instant case, Commission staff predicated its position upon the thirty-day rule of thumb in recommending that certain of United's advance payments be disallowed rate base treatment for purposes of determining the just and reasonable rates to be determined in this proceeding.

It is clear from the instant evidentiary record that $23,380,650 of the $79,238,960 of advanced payments made by United had not been expended by the various producer-recipients either during the locked-in period involved in this case or within thirty days subsequent to the end of this period. According to Commission staff's rule of thumb, therefore, the $23,380,650 of unexpended advances are, by definition, front-end and should be disallowed from United's rate base. In *Tennessee Gas Pipeline Co.*, Opinion No. 769, 55 F.P.C.—(July 9, 1976), *mimeo.*, pg. 31, the Commission held that front-end advance payments were presumptively extravagant under Order No. 499, 50 F.P.C. 2111 (1973), although the definition of front-end was left by the Commission to a case-by-case determination. Various front-end definitions have been advanced in cases on this point before

the Commission, among which is the Commission staff's thirty day rule of thumb. As the Commission recently reiterated,

> To begin with, a determination of reasonableness and appropriateness requires consideration of the common business practices of producers; however, we would have also considered evidence by the pipeline as to how it could reasonably finance its installment payments to the producers for specific expenditures. In other words a pipeline might be able to show that thirty days is too short. (*Tennessee Gas Pipeline Co.*, Opinion No. 769-A,—F.P.C.—(May 31, 1977 mimeo., pg. 9).

Clearly, the threshold issue is one of fact, to be determined with reference to the evidence introduced into the record.

In the instant case, Commission staff has come forward with various reasons that expenditure of advanced payments within thirty days of the end of the locked-in period must demarcate front-end advances (which are includable in the company's rate base) from others which have been made but are not appropriately recoverable from consumers through the rates herein considered. Staff's evidentiary presentation boils down to the concern that advances which have not been expended by the producer-recipient in furtherance of exploration and development were imprudently advanced in terms of timing and the carrying charges on this imprudent expenditure cannot properly be passed on to the consumer through these just and reasonable rates. United's presentation, of

course, defends the prudence of the timing of its advanced payments expenditures.

A finding that the advances are front-end, does not end the inquiry, for the Commission has held only that front-end advanced payments are "presumptively extravagant," a finding which may be rebutted by a showing that the front-end advance is, nevertheless, reasonable and appropriate because a positive benefit is conferred on the consumer. *See, e.g., Tennessee, supra,* at *mimeo.* pg. 32; *Transcontinental Gas Pipe Line Corp.*, Opinion No. 801,—F.P.C.—(May 31, 1977), *mimeo,* pg. 22. The advance payment agreement must be viewed as a whole in order to determine whether the overall cost of the expenditure to the consumer will be less than it would be otherwise, regardless of the front-end nature of the payment. The incentive for exploration and development by producers will cost the consumer, but if the total cost of a particular advance is, or could be, less if front-end, the incentive to the pipeline to bargain for more favorable terms from producers would have been destroyed if front-end or lump sum advances were strictly precluded. Accordingly, the question of whether a particular advance is "reasonable and appropriate" is properly resolved by determining on the whole of the evidence whether the incentive underlying the particular advanced payment was achieved at the lowest possible cost to the consumers.

In the instant case, United has made no showing whatsoever to rebut the presumption that the front-

end advances are extravagant. In the absence of such showing, the Commission finds that those sums advanced and not expended by the respective recipient-producers within thirty days of the end of the locked-in period in this case represents an extravagant expenditure by United and accordingly are not "reasonable and appropriate" for rate base treatment in this case.

(B) *Interest Reimbursements.*

While the Commission has consistenly construed the purpose of the advance payments program to be the *creation* of an alternative supply of capital available to producers to spur immediate exploration and development activity, the court in *United, supra,* found that the incentive for production and development by producers would be created as well by pipeline reimbursement of the carrying charges assessed the producer for capital procured from any source, including the normal capital markets. It is true that interest-free capital does provide an incentive to producers to step up exploration and development activities. United's alternative program of paying the interest charges on its producers' other capital commitments provides, in effect, interest-free loans to producers not substantively distinguishable from ordinary advance payments, other than the source of the capital.

The *United* court remanded to the Commission the question whether United's various interest reimbursement agreements "effected the same result as

the advance payment program and did so at a lower cost to the consumer and at less risk to the pipeline." *United, supra,* at pg. 465. If the purpose of the advance payments program is perceived as the court viewed it—*i.e.,* stimulation of current exploration and development for new reserves of gas, rather than the creation of an alternative source of capital for producers stymied in their efforts at capital formation—then it is clear that United's alternative program did effect the same result as the advance payment program." The question that remains is whether, judged under the standards applied to standard advance payments, these interest reimbursements qualify for cost of service (O&M expense) treatment as "reasonable and appropriate."

The question is whether interest reimbursement upon capital otherwise procured should be included in O&M expense unless the capital upon which the interest is advanced by United was actually expended in the activities intended to be inspired by the advance payment program. If the underlying capital was not so expended, the interest on that capital would be deemed unreasonable and inappropriate for recoupment in this rate case. The record in this case indicates that United advanced monies for the purpose of interest reimbursement, but it does not indicate that the underlying capital for which the interest is covered was, in fact, expended by the respective recipient-producer either within thirty days of the end of the locked-in period involved in this case or expended entirely for the purposes which the ad-

vanced payment program intended. Consequently, we cannot on this record make a finding that these expenditures should be included in United's cost of service.

Accordingly, we are required to remand this limited issue to the Presiding Administrative Law Judge for further proceedings to elicit evidence with respect to the timing and amount of producer expenditures of those funds upon which United assumed the obligation to pay interest. Pending decision on this issue, the terms of the Stipulation and Agreement with respect to United's refund liability on the increment associated with its interest reimbursements is found to fully protect United's consumer's interests. Consequently, we approve the Stipulation and Agreement, and reserve this question for further proceedings and determination on the merits of this issue.

III. *Miscellaneous Issues.*

Having disposed of the three primary issues reserved for hearing and decision by the stipulation among the parties, we turn now to several subsidiary issues raised during the hearings by individual parties. We note at the outset, however, that these issues are resolved by substantial agreement of the vast majority of parties to be affected and the Commission staff.

(A) *Federal Income Tax Allowance.*

The Stipulation and Agreement provides for a federal income tax component of $18,892,596 by agreement of substantially all affected parties. At hearing it was established that this component of the stipulated cost of service was arrived at through an application of the statutory 48% tax rate. Tr. 28. MDG argues that the use of the 48% statutory rate should be disallowed in favor of the alleged effective tax rate for the test period in this case. MDG relies upon *FPC* v. *United Gas Pipe Line Co.*, 386 U.S. 237 (1967), as assertedly requiring the use of only the actual taxes paid by a jurisdictional utility in determining just and reasonable rates.

This Commission's review of a proffered settlement provides a different context from that in which adverse parties present a disputed factual issue for decision. MDG's argument is predicated solely upon the fact that the settlement cost of service federal income tax component was derived through the use of the statutory rate. This is not substantial evidence that the settlement cost of service is inflated or excessive in any respect. While United certainly bears the burden of substantiating the reasonableness of its rate increase, we cannot find on this record any evidence that the agreed-upon use of the statutory rate is not just and reasonable. Furthermore, customers of United, each with an interest similar to MDG's in this proceeding, have compromised any objection which they may have had with respect to this

issue in the interest of overall settlement. The significant fact in this case is that the federal income tax figure agreed to by the parties herein in settlement was one element leading to settlement. Because settlements of litigation are favored and upon the principles expressed in *Pennsylvania Gas & Water Co.* v. *FPC*, 463 F.2d 1242 (D.C. Cir. 1972), we conclude that the record evidence in this case supports the instant settlement in respect to the tax component.

(B) *Interest Rate on Refunds.*

On June 15, 1976, MDG filed a petition with the Commission which requested that United be assessed interest on any refund liability arising in this case at the rate of 9% from October 10, 1974, rather than at the rate of 7% as stipulated by the parties in their settlement of this case. MDG suggests that this modification of the proffered Stipulation and Agreement is required by *American Public Gas Association* v. *FPC*, —— F.2d —— (D.C. Cir. 1976), wherein the Commission's decision to apply the increased 9% interest rate only to refunds on rate filings made after October 10, 1974, was reversed. On July 9, 1976, United answered MDG's petition in opposition to any change in the stipulated interest rate for refunds in this case.

The parties to this settlement have explicitly stipulated an interest rate to be applied to refunds in this proceeding. Nothing in the *APGA* decision limits the discretion of parties in settlement negotiations to agree to a lesser, or even greater, interest rate on

refunds than 9% for the period after October 10, 1974. Similarly, the *APGA* decision does not bar the Commission from accepting such agreements where appropriate.

We have previously stated that with respect to pending settlement agreements filed prior to December 6, 1976, where there is an indication of actual bargaining for a particular refund interest rate during the course of negotiations, the Commission will apply the settled upon interest rate. *Rate of Interest on Amount Subject to Refund*, RM74-18, Order Denying Rehearing and Further Clarifying Order No. 513-A, issued December 6, 1976, mimeo, p. 5. See also, *Natural Gas Pipeline Company of America*, Opinion No. 762-A, Docket No. RP74-96, issued December 6, 1976. However, where the Commission has no evidence to indicate the interest rate was bargained for as an integral and key part of the settlement, it has applied the 9% rate, *Northern Natural Gas Company*, Docket Nos. RP74-75, *et al.*, July 27, 1976.

United points out that the interest rate on refunds is an important element of any rate proceeding. But MDG is not directly controverted in its statement that the 7% rate "was not a negotiated figure but rather was included simply because that was what Order 513 seemed to require." MDG, pg. 3. Thus, the pleadings fail to demonstrate the interest rate was an integral or key part of the settlement. MDG's requested modification of the settlement is therefore accepted as consistent with the Commission's Rules in Section 154.67, 18 C.F.R. 154.67.

The Commission finds:

(1) United Gas Pipe Line Company is a "natural gas company" subject to the provisions of the Natural Gas Act, and the sales of natural gas subject to this order are sales of natural gas in interstate commerce for resale subject to the jurisdiction of the Commission.

(2) The proposed Stipulation and Agreement is just and reasonable, as modified by the provisions of this Opinion and Order.

(3) The collection of that portion of the instant increased rates attributable to United's noncertificated purchases is reasonable, subject to a contingent refund liability should it be determined that these purchases were made at a cost to United in excess of the applicable "just and reasonable", federally regulated price.

(4) The collection of that portion of the instant increased rates attributable to the $23,380,650 of United's advance payments herein determined to be a front-end and extravagant expenditure has not been shown to be just and reasonable under the Act and United should be required to file revised tariff sheets in this regard as necessary to conform to this order.

(5) The collection of that portion of the instant increased rates attributable to the $1,644,956 of other operation and maintenance expense reflecting United's reimbursement of interest on loans procured by producers (as alternatives to standard advance payment agreements) is reasonable as conditioned in the Stipulation and Agreement upon refund liability in the

event that, upon remand such reimbursement are found not "reasonable and appropriate".

(6) In all other respects the Stipulation and Agreement is found to be an adequate and just compromise of the matters at issue in this case and acceptance and approval of such Stipulation and Agreement is deemed to be in the public's interest and in conformance with the standards of the Natural Gas Act.

The Commission orders:

(A) The increased rates filed by United as reflected in the Stipulation and Agreement between the parties are disallowed to the extent that they do not conform to this opinion and order.

(B) Because the parties have stipulated refund procedures, United shall be required to undertake those refund obligations triggered in respect to finding Paragraph (4), *supra*, within sixty days of the issuance of this Opinion and Order.

(C) Within 60 days of the issuance of this Opinion and Order, United shall file revised tariff sheets for the Refund Period—April 6, 1974 through May 19, 1975—as required by finding paragraph (4), *supra*, which substitute sheets shall be subject to Commission review and approval.

(D) Within 30 days of the Commission's approval of Applicant's substitute tariff sheets in accordance with Paragraph (C) above, Applicant shall refund to its customers all amounts, if any, collected in excess of those which would have been payable under the rates and charges approved in accordance with Para-

graph (C) above, together with interest at a rate of nine percent per annum from the date of payment to Applicant to the date of refund.

(E) Within 15 days after refunds have been made United shall file with the Commission a compliance report showing monthly billing determinants and revenues under prior, present and adjudicated rates; monthly adjudicated rate increase, monthly rate refund, and the monthly interest computation, together with a summary of such information for the total refund period. A copy of such report shall also be furnished to each state commission within whose jurisdiction the wholesale customer distributes and sells natural gas at retail.

(F) Nothing herein shall be construed as removal of United's refund liability with respect to finding paragraphs (3) and (5), *supra*, which is contingent upon final Commission decisions in other proceedings.

(G) Upon any final Commission decision in the two proceedings referred to in (D) *supra*, triggering the stipulated refund obligations agreed upon among the parties to this case, the obligations shall be satisfied within 60 days of any such final Commission decision together with an obligation upon United ot file substittue tariff sheets necessary to reflect the

pertinent changes required by any such adverse resolution within the same 60 days.

By the Commission. Commissioner Holloman, dissenting, filed a separate statement appended hereto.

[SEAL]

LOIS D. CASHELL,
Acting Secretary.

HOLLOMAN, Commissioner, *dissenting*:

For the reasons articulated in my dissents to Opinion No. 769-A, *Tennessee Gas Pipeline Company*, Docket No. RP73-113, issued May 31, 1977, and Opinion No. 801, *Transcontinental Gas Pipeline Corportation*, Docket Nos. RP74-48 and RP 75-3, issued May 31, 1977, I dissent from the position taken by the Majority in this proceeding to the extent that the advance payments made by United Gas Pipe Line Company to various producer-recipients are excluded from rate base.

/s/ John H. Holloman III
JOHN H. HOLLOMAN, III
Commissioner

APPENDIX F

15 USC 717c provides in pertinent part:

SEC. 4. (a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.

* * * * *

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission, or gas distributing company, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commis-

sion may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

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IN THE

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OCTOBER TERM, 1979

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FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,

v.

UNITED GAS PIPE LINE COMPANY,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF RESPONDENT UNITED GAS PIPE LINE COMPANY IN OPPOSITION

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OPINIONS BELOW AND JURISDICTION

The opinions below are correctly referenced and the basis of this Court's jurisdiction is adequately described in the petition for a writ of certiorari.

QUESTION PRESENTED

Whether the Commission[1] arbitrarily, retroactively and without supporting evidence imposed a new standard establishing a presumption of extravagance in order to eliminate from the rate base of United Gas Pipe Line Company (United) certain advance payments made under contractual arrangements entered prior to the announcement of that presumption.

STATUTE AND REGULATION INVOLVED

The petition for a writ of certiorari raises questions involving Sections 4(a) and (e) of the Natural Gas Act (15 USC §§ 717(a) and (e)) and Commission Order No. 465, 48 FPC 1550 (1972), *reh. denied,* 49 FPC 517 (1973). The statutory language is accurately set forth in the petition for a writ of certiorari. The copy of Order No. 465 referenced in the petition for a writ of certiorari is an accurate copy of that order.

STATEMENT

The issues in this case arise out of the Commission's advance payments program. The advance payments program was created by the Commission in 1970[2] as an experiment designed to augment the supplies of gas available to

[1] Pursuant to the Department of Energy Organization Act, Pub. L. No. 95-91, 91 Stat. 565 (1977), 42 U.S.C.A. §§ 7101, *et seq.* (Supp. 1977), and Executive Order No. 12,009, 42 Fed. Reg. 46,267 (1977), on October 1, 1977 the Federal Power Commission (FPC) ceased to exist and most of its regulatory responsibilities, including those under Section 4 of the Natural Gas Act, 15 U.S.C. § 717c, were transferred to the Federal Energy Regulatory Commission (FERC). Accordingly, as used herein, the term "Commission" means the FPC when referring to actions taken prior to October 1, 1977 and means the FERC when referring to actions taken on or after October 1, 1977.

[2] *Accounting and Rate Treatment of Advance Payments to Suppliers for Gas and Amending FPC Form No. 2,* FPC Order No. 410, 44 F.P.C. 1142 (1970).

the interstate market. Under the program, pipeline companies provided interest-free advances of cash to producers for use by the producers in exploring for, developing and producing natural gas reserves for commitment to the interstate market. To encourage pipeline companies to make these interest-free advances and to offset partially the costs of making such advances, the Commission authorized pipeline companies to include the advance payments in their rate base.

The Commission instituted the advance payments program through a series of orders which periodically modified and extended the program.[3] Under these orders, the Commission periodically changed the specific conditions under

[3] *Accounting and Rate Treatment of Advance Payments to Suppliers for Gas and Amending F.P.C. Form No. 2,* FPC Order No. 410, 44 FPC 1142 (1970); *Accounting and Rate Treatment of Advance Payments to Suppliers for Gas and Amending F.P.C. Form No. 2,* FPC Order No. 410-A, 45 FPC 135 (1971); *Accounting and Rate Treatment of Advance Payments to Suppliers for Exploration and Lease Acquisition of Gas Producing Properties,* FPC Order No. 441, 46 FPC 1178 (1971), *reh. denied,* 47 FPC 57 (1972); *Accounting and Rate Treatment of Advance Payments Included in Account 166, Advance Payments for Gas Development and Production,* FPC Order No. 465, 48 FPC 1550 (1972), *reh. denied,* 49 FPC 517 (1973); *Accounting and Rate Treatment of Advances Included in Account No. 166, Advances for Gas Exploration, Development and Production,* FPC Order No. 499, 50 FPC 2111 (1973), *reh. denied,* 51 FPC 818 (1974); *Accounting and Rate Treatment of Advances Included in Account 166, Advances for Gas Exploration, Development and Production,* FPC Order No. 529 (June 17, 1975), *reh. denied,* FPC Order No. 529-A (August 15, 1975); *Accounting and Rate Treatment of Advances Including in Account No. 166, Advances for Gas Exploration, Development and Production,* Docket Nos. R-411 and RM74-4 (Order on Remand from Court Opinion Terminating Investigation and Terminating Advance Payment Program with Conditions) (December 31, 1975). Commission Order Nos. 410, 410-A and 441 were affirmed *sub nom. Public Service Comm'n of New York* v. *FPC,* 467 F.2d 361 (D.C. Cir. 1972); Commission Order Nos. 465 and 499 were remanded *sub nom. Public Service Comm'n of New York* v. *FPC,* 511 F.2d 338 (D.C. Cir. 1975) (hereinafter *New York Commission II*).

which an interstate gas pipeline could make advance payments qualifying for rate base treatment.[4] In each instance in which the Commission added new conditions to the advance payment program, the Commission order explicitly stated that the changes were applicable only to advance payment agreements made after the new requirement was promulgated.

Prior to December 28, 1973, the Commission had given no indication that a relationship existed between a pipeline's inclusion of an advance payment in its rate base and the expenditure of that advance by the recipient producer. On that date, the Commission issued Order No. 499, in which it stated that "as a general policy" the Commission would not permit pipeline companies to include advance payments in their rate base unless the natural gas producer expended the advance "within a *reasonable* time from the date such amounts advanced are included in the pipeline's rate base." 50 FPC at 2115 (emphasis supplied). On rehearing of Order No. 499, the Commission rejected the pipelines' requests for specific guidelines as to what is a "reasonable time", stating:

> "we believe it is appropriate to set no rigid standards for review of such advances, but rather to examine each advance on a case by case basis." 51 FPC at 819.

[4] For example, Order No. 441 added a requirement that the advance be repaid even if production was not obtained (under prior orders advance payments could be repayable only if, and to the extent that, gas was found and produced); Order No. 465 required, for the first time, that advances be removed from rate base at the end of five years if deliveries had not commenced or if gas developed with the advance was sold to another company; and Order No. 529 added requirements that (1) the pipeline making the advance receive a first call on gas produced; (2) such gas be committed to the pipeline under a long term contract; (3) the producer agree to accept a just and reasonable rate as established by the Commission; and (4) pipelines pay interest on amounts which must be refunded if the gas is sold to another company.

The D.C. Circuit on review of Order No. 499 characterized the announcement of this timing policy as "the only limitation" added by that order. *New York Pub. Serv. Comm'n* v. *FPC*, 511 F.2d at 344.

The circumstances existing at the time United made its advance payment agreements have never been in dispute. Specifically, it is undisputed that (1) United was forced by supply shortages to curtail deliveries to its customers and therefore needed additional gas supplies; (2) from the inception of the advance payment program advance payments were the *sine qua non* for commitment of significant new supplies; and (3) virtually all advance payments being made at the time were "front-end" advances, *i.e.*, advances made prior to expenditure by the producer.

United made the advance payments at issue in this case during 1973, while Order No. 465 was in effect.[5] Pursuant to that order, United included the amounts advanced in its rate base in general rate increase filings made under Section 4 of the Natural Gas Act on September 21, 1973 and April 15, 1974. These two rate filings, which the Commission assigned Docket Nos. RP74-20 and RP74-83 respectively, were consolidated for purposes of hearing and decision. Settlement negotiations in the consolidated docket ultimately resulted in a Stipulation and Agreement dated August 1, 1975 (hereinafter referred to as the "Settlement Agreement"). Evidentiary hearings on the Settlement Agreement, including the treatment of advance payments thereunder, were held before an Administrative

[5] A small amount attributable to advance payment agreements made under Order No. 499 was also involved in the case before the Fifth Circuit below; however, the Commission has not petitioned for a writ of certiorari with respect to the Fifth Circuit's treatment of those agreements. Advance payments executed during the existence of both Order No. 465 and Order No. 499 have also been included in rate base in subsequent rate filings.

Law Judge of the Commission on December 2, 1975. The Settlement Agreement and hearing record were then certified to the Commission on December 24, 1975. On July 29, 1977, the Commission issued Opinion No. 815. (Petition for Writ, 44a – 72a). Those modifications included, among other things, denial of rate base treatment for $23,380,650 of advance payments on the grounds that such amounts had not been expended by the *producer* within thirty days of inclusion in United's rate base and resulting rate.[6] The Commission contended that advance payments made more than 30 days prior to expenditure by the producer were "presumptively extravagant." (Petition for Writ, 60a). Neither the Commission nor its Staff ever contended that United could actually have obtained gas commitments if it had restricted its advances to amounts to be spent by the producer within 30 days and indeed, in Opinion No. 815-A, the Commission expressly disclaimed any suggestion that United had acted unwisely in making front end advances. "We do *not* find that, as a matter of business acumen, United was unwise to enter into advance payment agreements". (Petition for Writ, 32a) (emphasis in original).

Pursuant to Section 19 of the Natural Gas Act, United sought rehearing of Opinion No. 815 and, when rehearing was denied in Opinion No. 815-A (Petition for Writ, 25a – 43a), filed its petition for review in the United States Court of Appeals for the Fifth Circuit.

In a decision issued on June 22, 1979 (Petition for Writ, 1a – 20a), the court below reversed Opinion Nos. 815 and 815-A with respect to the treatment of United's advance payments governed by Order No. 465 and reversed and remanded Opinion Nos. 815 and 815-A with respect to the treatment of those advance payments governed by Order

[6] There was no dispute that the amounts had, in fact, been advanced by United to the producers prior to inclusion in United's rate base.

No. 499. The Fifth Circuit decision explains that, particularly for those payments subject to Order No. 465, the application of the Commission's 30-day "presumption" would arbitrarily impose a new and previously unannounced dimension and restraint governing permissible advance payments. (Petition for Writ, 13a). The court found that none of the Commission advance payment orders between 1970 and 1973 had "specified a concrete timing relationship between pipeline's advance and producer's expenditures," (Petition for Writ, 12a) and pointed out that when — in Order No. 499 — the Commission did announce a policy to require a temporal relationship between the pipeline's advance and the producer's expenditure, it provided only that the advance should be expended "within a reasonable time after their inclusion in rate base." (Petition for Writ, 13a). The court noted that the Commission did not announce its 30-day line-of-credit requirement until Opinion No. 769 was issued in July 1976[7], more than three years after the advance payments in issue were made, and concluded that "the law will not tolerate this sort of after-the-fact, in fact retroactive, imposition of standards" (Petition for Writ, 14a) to advance payments made years earlier, and indeed prior to announcement of even the "reasonable time" policy of Order No. 499. The court found that there was "simply no evidence either to support or justify the presumption of extravagance for these non-thirty day advances." (Petition for Writ, 14a). The Fifth Circuit denied rehearing of its decision on August 8, 1979. (Petition for Writ, 23a, 24a).

[7] *Tennessee Gas Pipeline Co.*, Opinion No. 769, 55 FPC .... (July 9, 1976), *reh. denied*, Opinion No. 769-A, 56 FPC .... (May 31, 1977), remanded *sub nom. Tennessee Gas Pipeline Company, et al* v. *FERC*, 606 F.2d 1094 (D.C. Cir. 1979), *cert. filed*, December 19, 1979 (No. 79-962) (hereinafter cited as "*Tennessee*").

ARGUMENT

The Commission has failed to state a basis for certiorari in this case. Although the Commission asserts that the decision of the Fifth Circuit in this case is in conflict with the decision of the D.C. Circuit in *Tennessee,* it acknowledges that the alleged conflict over the interpretation of an expired program does not merit review by this Court.[8] (Petition for Writ, 9-10). We agree.

The only theory the Commission advances in support of its petition for certiorari is that if the Court grants certiorari in *Tennessee* — which the Commission opposes — then it should grant certiorari in this case so that the treatment of pipelines may be "uniform". This claimed need for uniformity is pure makeweight[9] and is, in fact, contrary to

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[8] In fact the alleged differences between the decisions of the courts in *United* and *Tennessee* are more apparent than real. Both courts unequivocally rejected the Commission's attempt to impose a 30-day line-of-credit test on advance payments made under either Order No. 465 or Order No. 499. [The Seventh Circuit had previously rejected the 30-day line-of-credit test in a case involving solely Order 499 advances. *Natural Gas Pipeline Company of America* v. *FERC*, 590 F.2d 664 (7th Cir. 1979).] In *United,* the Fifth Circuit held that the law would not tolerate retroactive application of the 30-day line-of-credit test to United's Order No. 465 advances and found that "there was simply no evidence either to support or justify the presumption of extravagance" for these advances. Accordingly, the Court reversed with respect to those agreements. In *Tennessee,* the D.C. Circuit similarly held that application of the 30-day line-of-credit test to Tennessee's advances was unlawful but remanded the case "for a more extensive and flexible inquiry by the Commission into the reasonableness of attempts to protect the rate payers from excessive costs." *Tennessee, supra.* (606 F.2d at 1118-9).

[9] Were the Commission contending that the results in *United* and *Tennessee* were identical and that parallel grant or denial of certiorari was required to preserve that uniformity, the Commission's theory would appear more rational. But here, although the Commission alleges that the decision of the courts below are in conflict, the Commission is urging that both of the decisions below should be allowed to stand.

the Commission's long-standing position that advance payments must be reviewed on a case-by-case basis. This position was reiterated by the Commission in its decision below when it stated:

> "We have consistently indicated that the rate treatment for advance payments will be decided on a case-by-case basis." (Petition for Writ, 30a).

Significantly, the Commission contends that the differences between the decision of the courts in *United* and *Tennessee* are not sufficiently important to require action of this Court to provide "uniformity". Since any decision of this Court on the merits in *Tennessee* can only reduce or maintain, not increase, those differences, it is clear that grant of the petition for certiorari in Tennessee could not be an adequate reason to grant certiorari in this case.[10]

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[10] The D.C. Circuit has reversed the Commission in *Tennessee,* as did the court below. While affirmance of the Commission in *Tennessee* might, *arguendo,* create a conflict between circuits, no one appears to be urging that the D.C. Circuit be reversed and the Commission affirmed. If certiorari is granted in *Tennessee* and the petitioner's position therein adopted, the opinions of the circuits will be parallel. On the other hand, should the opinion of the D.C. Circuit not be modified, further proceedings by the Commission will be required. The existence of a conflict before the conclusion of these subsequent Commission proceedings is purely conjectural.

CONCLUSION

For the foregoing reasons, United respectfully submits that there is no basis for this Court to consider the decision of the Fifth Circuit in the proceedings below, and that the Court should deny the Commission's contingent petition for certiorari.

Respectfully submitted,

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